No. 97-1418-CFX Title: Bank of America National Trust and Savings Association, Petitioner
v.
203 North LaSalle Street Partnership

Docketed:
March 2, 1998 Court: United States Court of Appeals for the Seventh Circuit

Entry	Date	Proceedings and Orders
	Feb 23 1998	Petition for writ of certiorari filed. (Response due April 1, 1998)
	Mar 31 1998	Motion of American College of Real Estate Lawyers for leave to file a brief as amicus curiae filed.
	Mar 31 1998	Brief of respondent 203 North LaSalle Street Partnership in opposition filed.
	Apr 1 1998	Motion of American Council of Life Insurance for leave to file a brief as amicus curiae filed.
	Apr 1 1998	Motion of American Bankers Association, et al. for leave to file a brief as amici curiae filed.
	Apr 9 1998	Reply brief of petitioner Bank of America National Trust and Savings Association filed.
	Apr 15 1998	DISTRIBUTED. May 1, 1998
	May 4 1998	Motion of American College of Real Estate Lawyers for leave to file a brief as amicus curiae GRANTED.
	May 4 1998	Motion of American Council of Life Insurance for leave to file a brief as amicus curiae GRANTED.
	May 4 1998	Motion of American Bankers Association, et al. for leave to file a brief as amici curiae GRANTED.
	May 4 1998	Petition GRANTED. SET FOR ARGUMENT November 2, 1998. **********
	May 18 1998	Motion of respondent to dismiss as improvidently granted filed.
	May 21 1998	Opposition of petitioner to motion of respondent filed.
	Jun 4 1998	Order extending time to file brief of petitioner on the merits until June 26, 1998.
	Jun 8 1998	Motion of respondent to dismiss as improvidently granted DENIED.
	Jun 25 1998	Brief amicus curiae of American College of Real Estate Lawyers filed.
	Jun 26 1998	Brief amicus curiae of American Council of Life Insurance filed.
	Jun 26 1998	Brief amici curiae of Ronald Mann, et al. filed.
	Jun 26 1998	Brief amici curiae of American Bankers Association, et al. filed.
	Jun 26 1998	Brief amicus curiae of United States filed.
	Jun 26 1998	Joint appendix filed.
	Jun 26 1998	Brief of petitioner Bank of America National Trust and Savings Association filed.
	Jul 9 1998	Order extending time to file brief of respondent on the merits until August 17, 1998.
	Jul 10 1998	Motion of Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.

2 pp

No. 97-1418-CFX

Entry	Date	Proceedings and Orders
	Aug 17 1998	Brief of respondent 203 North LaSalle Street Partnership filed.
	Aug 17 1998	Brief amicus curiae of National Association of Credit Management filed.
	Aug 17 1998	Brief amicus curiae of Bruce A. Markell filed.
	Aug 17 1998	Brief amici curiae of National Small Business United, et al. filed.
	Aug 27 1998	Motion of Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
	Sep 2 1998	Record filed.
	Sep 8 1998	Application (A98-212) to extend the time to file a reply brief from September 16, 1998 to September 30, 1998 by petitioner, submitted to Justice Stevens.
	Sep 9 1998	Application (A98-212) granted by Justice Stevens extending the time to file until September 30, 1998.
	Sep 25 1998	CIRCULATED.
	Sep 29 1998	Reply brief of petitioner Bank of America National Trust and Savings Association filed.
	Oct 15 1998	Supplemental brief of respondent filed.
	Oct 19 1998	Supplemental brief of petitioner filed.
	Oct 20 1998	LODGING consisting of 19 copies of an article submitted by counsel for the respondent received and distributed.
	Oct 30 1998	Record filed.
	Nov 2 1998	ARGUED.

Supreme Court, U.S.
FILED

97 1418 FEB 23 1998

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No. _____

In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Successor by merger to Bank of America Illinois,
Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The absolute priority rule, codified at 11 U.S.C. § 1129(b)(2)(B)(ii), provides that a plan of reorganization under Chapter 11 of the Bankruptcy Code may not be confirmed unless either all dissenting classes of unsecured creditors are paid in full, or no holder of a more junior claim or interest "receive[s] or retain[s] under the plan on account of such junior claim or interest any property."

The question presented in this case is the same one this Court granted certiorari to consider, but did not resolve, in *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 513 U.S. 18 (1994):

Whether the Bankruptcy Code authorizes a judge to confirm a Chapter 11 plan of reorganization that grants the pre-bankruptcy equity owners of a debtor an exclusive opportunity to retain or purchase an ownership interest in the reorganized debtor, but does not provide for full payment to a senior, objecting class of unsecured creditors.

RULE 14.1(b) AND 29.6 STATEMENT

The parties in the court of appeals were Petitioner Bank of America Illinois, now known, as a result of a merger, as Bank of America National Trust and Savings Association, and Respondent 203 North LaSalle Street Partnership, an Illinois limited partnership.

Petitioner Bank of America National Trust and Savings Association is a wholly owned subsidiary of BankAmerica Corporation, which is a publicly held company. Bank of America National Trust and Savings Association has no nonwholly owned subsidiaries.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

RULE 14.1(b) AND 29.6 STATEMENT ii

OPINIONS BELOW 1

JURISDICTION 1

STATUTE INVOLVED 1

STATEMENT 2

A. The Absolute Priority Rule 2

B. Factual Background 3

C. Proceedings In The Court Of Appeals 5

REASONS FOR GRANTING THE WRIT 7

I. COURTS AND COMMENTATORS ARE SHARPLY DIVIDED ON THE VALIDITY OF A NEW VALUE EXCEPTION TO THE ABSOLUTE PRIORITY RULE 9

II. WHETHER THERE IS A NEW VALUE EXCEPTION TO THE ABSOLUTE PRIORITY RULE IS AN IMPORTANT AND RECURRING ISSUE 15

III. THE PANEL MAJORITY'S DECISION IS FUNDAMENTALLY FLAWED 18

A. The Plain Statutory Language Does Not Include A New Value Exception 19

B. Congress Did Not Adopt The New Value Exception *Sub Silentio* When It Enacted The Bankruptcy Code In 1978 24

C. A New Value Exception Would Be Inconsistent With The Policies Underlying The Bankruptcy Code 27

CONCLUSION 30

TABLE OF AUTHORITIES

Cases **Page**

A.V.B.I., Inc., In re, 143 B.R. 738 (Bankr. C.D. Cal. 1992) 29

Bates v. *United States*, 118 S. Ct. 285 (1997) 20

Bonner Mall Partnership, In re, 2 F.3d 899 (9th Cir. 1993) 11, 12, 13, 14, 17

Bryson Properties, In re, 961 F.2d 496 (4th Cir. 1992) 7, 10, 11, 13, 22

Caminetti v. *United States*, 242 U.S. 470 (1917) 19

Case v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939) . . . . . *passim*

CFTC v. *Weintraub*, 471 U.S. 343 (1985) 28

Coltex Loop Central Three Partners, L.P., In re, No. 96-5140 (2d Cir. Feb. 19, 1998) . . . . . *passim*

Connecticut Nat'l Bank v. *Germain*, 503 U.S. 249 (1992) 19

Dewsnup v. *Timm*, 502 U.S. 410 (1992) 21

Greystone III Joint Venture, In re, 995 F.2d 1274 (5th Cir. 1991) 13, 17, 22, 27, 28

Homestead Partners, Ltd., In re, 197 B.R. 706 (Bankr. N.D. Ga. 1996) 22

Kham & Nate's Shoes No. 2, Inc. v. *First Bank*, 908 F.2d 1351 (7th Cir. 1990) . . . . . *passim*

Norwest Bank Worthington v. *Ahlers*, 485 U.S. 197 (1988) . . . . . *passim*

Patterson v. *Shumate*, 504 U.S. 753 (1992) 23

Pennsylvania Dep't of Public Welfare v. *Davenport*, 495 U.S. 552 (1990) 21

U.S. Bancorp Mortgage Co. v. *Bonner Mall Partnership*, 513 U.S. 18 (1994) . . . . . *passim*

U.S. Truck Co., In re, 800 F.2d 581 (6th Cir. 1986) . . 12

Union Bank v. *Wolas*, 502 U.S. 151 (1991) 21, 27

United States v. *Ron Pair Enterprises*, 489 U.S. 235 (1989) 19, 20

W.A. Mallory Co., In re, 214 B.R. 834 (Bankr. E.D. Va. 1997) 29

Statutes

11 U.S.C. § 363 29

11 U.S.C. § 510(c) 23

11 U.S.C. § 1121 18

11 U.S.C. § 1126(c) 26, 27

11 U.S.C. § 1129(b) 1, 9, 11, 21

11 U.S.C. § 1129(b)(1) 27

11 U.S.C. § 1129(b)(2) 27

11 U.S.C. § 1129(b)(2)(B) 5, 8

11 U.S.C. § 1129(b)(2)(B)(ii) . . . . . *passim*

Bankruptcy Act of 1898, Chapters X, XI, and XII 26, 27

Other Authorities

John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963 (1989) 24

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Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. CHI. L. REV. 651 (1974) 30

5 COLLIER ON BANKRUPTCY ¶ 1129.03[e][i] (L. King 15th ed. 1996) 15

7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c] (L. King 15th ed. rev. 1997) 12, 15, 25

124 Cong. Rec. H11095 (daily ed. Sept. 28, 1978) . . . 23

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H.R. Rep. No. 95-595 (1977) 9

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Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69 (1991) 7, 8, 16, 24, 26

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Bank of America National Trust and Savings Association, successor by merger to Bank of America Illinois (the "Bank"), respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The opinion of a divided panel of the court of appeals (App., *infra*, 1a-47a) is reported at 126 F.3d 955. The order of the court of appeals denying rehearing and denying rehearing en banc by a 5-5 vote (App., *infra*, 48a-49a) is not reported. The opinion of the district court (App., *infra*, 50a-101a) is reported at 195 B.R. 692. The opinion of the bankruptcy court (App., *infra*, 102a-154a) is reported at 190 B.R. 567.

JURISDICTION

The judgment of the court of appeals was entered on September 29, 1997. App., *infra*, 1a. A timely petition for rehearing was denied on November 25, 1997. App., *infra*, 48a-49a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

11 U.S.C. § 1129(b) provides in pertinent part:

(1) * * * the court * * * shall confirm the plan * * * if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable * * * includes the following requirements:

* * *

(B) With respect to a class of unsecured claims —

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

STATEMENT

A. The Absolute Priority Rule

The absolute priority rule in bankruptcy "provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988) (internal quotation marks omitted). The rule was originally a judicial development but now is incorporated into the Bankruptcy Code, in 11 U.S.C. § 1129(b)(2)(B)(ii). *Ahlers*, 485 U.S. at 202.

Justice Douglas's opinion for the Court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 121-122 (1939), contained dicta that have been read to suggest that there was or is a new value exception to the absolute priority rule. *Ahlers*, 485 U.S. at 203. Such an exception, if it exists, would allow the debtor's pre-petition equity holders the right (perhaps the exclusive right) to retain an interest in the reorganized debtor, despite not providing for more senior classes in full, if a bankruptcy judge determines that they have made substantial new contributions in money or money's worth that are reasonably equivalent to the retained interest and necessary to a successful reorganization. App., *infra*, 14a.

The new value exception is difficult to reconcile with the language of Section 1129(b)(2)(B)(ii), which forbids pre-

petition equity holders to "receive or retain under the plan *on account of such junior claim or interest* any property" unless more senior interests consent or are paid in full (emphasis added). Accordingly, this Court in *Ahlers* left open the question whether any new value exception exists. 485 U.S. at 203 n.3. Proponents of the new value exception maintain, however, that it is not actually an "exception" but a "corollary" to the absolute priority rule, because the equity holders' post-petition interests are received "on account of" the contributed new value rather than "on account of" their pre-petition interest. See App., *infra*, 17a, 21a.

This case squarely presents the question left open in *Ahlers*. The Seventh Circuit not only held that a new value exception exists, but also applied it to confirm an otherwise-unconfirmable plan of reorganization. The court did so even though the debtors were given the *exclusive* opportunity to buy into the reorganized debtor by contributing new value.

B. Factual Background

The debtor in this case, respondent 203 North LaSalle Street Partnership, is a real estate limited partnership whose principal asset is fifteen floors of an office building in downtown Chicago (the "Property"). App., *infra*, 2a. The debtor owes the Bank more than $93 million; the debt is secured by a non-recourse first mortgage on the Property that came due in January 1995. *Ibid*. When the debtor was unable to repay the loan, the Bank began foreclosure proceedings; shortly thereafter, the debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. *Ibid*.

At the time the bankruptcy court confirmed the debtor's Chapter 11 plan of reorganization, the debtor was insolvent and the Bank's secured claim was valued at $54.5 million, leaving the Bank with an unsecured deficiency claim of $38.5 million. App., *infra*, 4a n.4, 115a. The bankruptcy court

found that the Property would not appreciate in value during the term of the plan such that (1) the debtor would ever become solvent, or (2) the Bank would ever receive payment in full of its unsecured claim. *Id.* at 133a. The bankruptcy court also found that the present value of what the Bank would ultimately receive on its unsecured claim under the plan was only about 16% of the Bank's unsecured $38.5 million claim. *Id.* at 28a, 133a. These findings were not disturbed on appeal.

In addition to ensuring that the Bank would never receive payment in full of its $38.5 million unsecured claim, the plan gave the debtor's pre-bankruptcy equity holders the *exclusive* right to retain their equity interests in the debtor if they contributed new capital, the cash or cash equivalent portion of which had a present value of $4.1 million, to be paid over five years.[1] App. *infra*, 4a, 24a, 34a, 111a-112a. Only the debtor's pre-petition equity holders were given the opportunity to contribute new capital in exchange for retention of an ownership interest in the reorganized debtor. *Ibid.*

The Bank, by far the debtor's largest creditor, objected to confirmation on the ground, among others, that the plan violated the absolute priority rule, because the debtor's pre-bankruptcy equity holders had the exclusive right to retain their equity interests in the debtor even though the Bank's senior, unsecured claim was not satisfied in full under the

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[1] Although the ordinary rationale for Chapter 11 reorganization is to ensure that a business with going-concern value can continue in operation despite cash-flow problems that leave it temporarily unable to meet its obligations, that was not the rationale here. As the bankruptcy court specifically found, the partners who owned the debtor in this case were motivated by another consideration: they would owe some $20 million in income taxes if the Bank were permitted to foreclose. App., *infra*, 3a, 112a-113a.

plan. App., *infra*, 3a. The bankruptcy court nonetheless confirmed the plan; the court held that, although the plan ran afoul of the absolute priority rule, that rule was limited by the new value exception, which the plan satisfied. *Id.* at 135a-140a. The district court affirmed the bankruptcy court's decision. *Id.* at 79a-85a.

C. Proceedings In The Court Of Appeals

A divided Seventh Circuit panel upheld confirmation of the plan, holding among other things that the absolute priority rule codified at 11 U.S.C. § 1129(b)(2)(B) is subject to the new value exception (or new value "corollary"). App., *infra*, 13a-23a. Acknowledging that courts and commentators are "quite divided over this issue," *id.* at 18a n.8, the majority reasoned that

- This Court "established" the new value exception in *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), App., *infra*, 14a;
- "[F]or more than fifty years, the new value precept has been recognized as an important corollary or exception to the absolute priority rule," *id.* at 19a;
- When Congress adopted the Bankruptcy Code in 1978, there is "no question" that it "'must have enacted the Code with a full understanding' of the absolute priority rule and its new value corollary," *id.* at 20a; and
- Although "Congress did not explicitly codify the new value corollary" in the Code, the corollary "remains a part of our bankruptcy jurisprudence" because "Congress never explicitly declared * * * that it intended the

abolition" of the doctrine, *id.* at 15a, 20a-21a, 23a.

Judge Kanne dissented. To begin with, Judge Kanne explained, "the plain language of the absolute priority rule, *see* 11 U.S.C. § 1129(b)(2)(B)(ii), does not include a new value exception"; indeed, the statutory text "fails to even hint at" the existence of a new value exception. App., *infra*, 32a, 34a. Recognition of a new value exception is thus inconsistent with "the straightforward text of the statutory absolute priority rule." *Id.* at 38a.

In addition, Judge Kanne concluded that it is not reasonable to assume that Congress implicitly incorporated the new value exception into Section 1129(b)(2)(B)(ii), for two reasons. First, the new value exception rests on a "questionable foundation" under pre-Code law — dicta in *Case*, which "no reported case expressly adopted * * * as its holding until the Code's enactment in 1978" and which has since "'taken on a life of its own in the lower courts.'" *Id.* at 41a, 42a n.5. Second, the principles underlying the new value exception "differ greatly from those under the present Bankruptcy Code." *Id.* at 42a. Because of "the massive changes in bankruptcy procedures brought on by the Bankruptcy Code," "strict adherence to the pre-Code new value exception might *contravene* Congress's intent in codifying the absolute priority rule" and, at a minimum, does not indicate "Congress's intent to *include* a new value exception in § 1129(b)(2)(B)(ii)." *Id.* at 32a, 40a-41a (second emphasis added).

Only 10 of the 11 judges of the court of appeals considered the Bank's request for rehearing *en banc*. Judges Coffey, Easterbrook, Manion, Kanne, and Diane P. Wood voted to grant rehearing *en banc*, but the resultant 5-5 tie led to a denial of rehearing. App., *infra*, 48a-49a.

REASONS FOR GRANTING THE WRIT

Four years ago, this Court granted certiorari in *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 513 U.S. 18 (1994), to decide an issue the Court left open in *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 203 n.3 (1988): whether there is a new value exception to the absolute priority rule as codified in the Bankruptcy Code. That question is still unresolved. The Court did not decide the issue in *Bonner Mall* — it dismissed the case as moot after the parties settled, see 513 U.S. at 29 — and since then the validity of a new value exception has continued to be the subject of vigorous debate by judges and commentators alike. See App., *infra*, 18a n.8 (majority opinion), 35a n.2 (dissenting opinion). As one leading scholar has stated, the existence of a new value exception is "[o]ne of the great unresolved questions in the Bankruptcy Code." DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 259 (1993). But until this Court provides a definitive answer to that question, "interpretative chaos reigns" in the lower federal courts. Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 94 (1991).

The Seventh Circuit's ruling here conflicts directly with decisions of both the Second Circuit, *In re Coltex Loop Central Three Partners, L.P.*, No. 96-5140, slip op. 7-17 (2d Cir. Feb. 19, 1998), and the Fourth Circuit, *In re Bryson Properties*, 961 F.2d 496, 504-505 (4th Cir. 1992). The Second Circuit, in fact, has explicitly rejected the panel majority's holding in this case, instead adopting Judge Kanne's dissent. *Coltex*, slip op. 8 ("the reasoning for our conclusion has been explained very well by the dissent in *LaSalle*").

In both *Ahlers* and *Bonner Mall*, the United States appeared as amicus curiae and urged this Court to hold that the new value exception does not exist or, at a minimum, is

not so broad as to permit confirmation of a plan (such as the one here) in which the pre-petition equity holders receive the *exclusive* opportunity to receive a post-petition interest in return for an infusion of "new value." The government took that position in briefs signed by two different Solicitors General, appointed by two different Presidents. Thus, the Seventh Circuit's decision to allow confirmation of a "new value" plan featuring equity holder exclusivity conflicts with the considered views of the Executive Branch as well as decisions of the Second and Fourth Circuits and many lower courts.

The panel majority's decision also is at odds with the Bankruptcy Code. The existence of a new value exception is inconsistent with the plain language of Section 1129(b)(2)(B) as well as with the fundamental policy underlying the Bankruptcy Code: that the interests of creditors take precedence over the interests of an insolvent debtor's equity holders. The new value exception contravenes that policy by permitting an insolvent debtor's insiders — who no longer have any economic interest in the debtor's property — to grant themselves the exclusive opportunity to obtain interests in the reorganized property without having to worry about competitive bids from creditors or outsiders. As a result, during the negotiations that accompany any proposed plan of reorganization, bargaining leverage will be tilted heavily in favor of the insolvent debtor's equity holders and away from its creditors.

There is little to be gained from further consideration of the issue by lower levels of the judiciary. Hundreds of decisions and law review articles have discussed the new value exception in excruciating detail, considering every possible nuance of the issue. In the meantime, plans of reorganization that are premised on the existence of a new value exception are becoming increasingly common. Since 1978, "there has been an explosion of cases which discuss the new value 'exception' to the absolute priority rule." Markell, *supra*, 44

STAN. L. REV. at 93. This trend has continued in the four years since the Court granted certiorari in *Bonner Mall*.

Whether there is a new value exception to the absolute priority rule needs to be resolved once and for all. The question has enormous practical significance in reorganizations under Chapter 11 and is squarely presented by this case. The petition should be granted.

I. COURTS AND COMMENTATORS ARE SHARPLY DIVIDED ON THE VALIDITY OF A NEW VALUE EXCEPTION TO THE ABSOLUTE PRIORITY RULE

Unless a plan of reorganization provides for payment in full to a dissenting, senior class of unsecured creditors, the absolute priority rule prohibits the confirmation of any plan if a junior class of unsecured creditors or equity interest holders "receive[s] or retain[s] under the plan on account of such junior claim or interest *any property*." 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added). See also *Ahlers*, 485 U.S. at 202 ("'a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan'"). Twice in recent years, this Court has expressly left open whether the absolute priority rule is subject to a new value exception. *Id.* at 203 n.3; *Bonner Mall*, 513 U.S. at 20 n.1. Since *Ahlers*, the lower federal courts have provided flatly inconsistent answers to that question.

1. It cannot seriously be doubted that the exclusive right to retain an equity interest in a business enterprise is "property" within the meaning of Section 1129(b)(2)(B)(ii). "[W]hile the Code itself does not define what 'property' means as the term is used in § 1129(b), the relevant legislative history suggests that Congress' meaning was quite broad," and included "'both tangible and intangible property.'" *Ahlers*, 485 U.S. at 208 (quoting H.R. Rep. No. 95-

595, at 413 (1977)). Thus, "[e]ven where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains 'property.'" *Id.* at 207-208. See also, *e.g.*, *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990) ("[a]n option to purchase stock also is 'property'" under § 1129(b)).

The Second and Fourth Circuits have relied on this broad definition of property in overturning confirmations of plans of reorganization that were the same in all material respects as the plan upheld by the Seventh Circuit in this case. Like the plan here, the *Coltex* and *Bryson* plans provided the debtor's pre-bankruptcy equity holders with the exclusive right to contribute new capital to, and receive equity interests in, the reorganized debtor, while at the same time denying full payment to senior classes of unsecured creditors. *Coltex*, slip op. 9; *Bryson*, 961 F.2d at 504-505. Applying what each court held was "plain" statutory language, the Second and Fourth Circuits ruled that the plans violated the absolute priority rule. See *Coltex*, slip op. 9 ("the *exclusive* right to retain the debtor's property upon making a capital contribution is itself property," which was received "on account of equity's prior position"); *Bryson*, 961 F.2d at 504 (the "exclusive right to contribute [new capital] constitutes 'property' under § 1129(b)(2)(B)(ii), which was received or retained on account of a prior interest").[2]

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[2] In *Bryson*, the Fourth Circuit also noted in passing that the proposed plan gave the equity holders "the right to return of their new capital prior to [the senior creditor's] recovery of its unsecured claim," 961 F.2d at 504, but that fact played no role in the court's ultimate holding. Rather, the court stated that its decision turned on "whether the equityholders receive[d] anything 'on account of' their prior interest" — and the only "'property'" that the court held "was received or retained on account of a prior interest" was the

(continued...)

On the same operative facts, the panel majority here reached precisely the opposite conclusion. The majority held that a plan that offered the debtor's prior equity owners the exclusive right to retain their ownership interests, in exchange for a contribution of new capital, passed muster under the Bankruptcy Code because the new value exception "remains a part of our bankruptcy jurisprudence." App., *infra*, 23a.

The panel majority's holding conflicts directly with the decisions of the Second and Fourth Circuits. The *Coltex* court expressly agreed with the dissent in this case. The *Bryson* court stopped short of holding that the new value exception is not embodied in Section 1129(b), but its holding would require a different outcome in this case than the one reached by the Seventh Circuit. Both the Second and Fourth Circuits concluded that, even if a limited new value exception existed under the Code, it would not apply when a plan gave prior equity owners the *exclusive* opportunity to contribute new capital and receive or retain an equity interest in the reorganized business. *Coltex*, slip op. 13-14, 17; *Bryson*, 961 F.2d at 505. The same *exclusive* opportunity for prior equity holders exists in this case and in most other Chapter 11 proceedings in which a new value plan is proposed (including *Bonner Mall*).[3] See, *e.g.*, BAIRD, ELEMENTS OF BANKRUPTCY

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[2] (...continued)
"exclusive right to *contribute*" new capital. *Ibid.* (emphasis added). In *Coltex*, the Second Circuit speculated that in the Seventh Circuit's *LaSalle* decision "it does not appear that the lender attempted to file a competing plan." Slip op. 7 n.1. In fact, the Bank *did* move to file a competing plan of reorganization here; the bankruptcy court denied that request. BAI R. 104.

[3] For extensive criticism of the Ninth Circuit's *Bonner Mall* decision (equally applicable to this case) on the ground that it

(continued...)

at 261. Had the present case arisen in the Second Circuit or the Fourth Circuit, those courts would have rejected the same plan of reorganization that the Seventh Circuit accepted.

2. In other cases, as well, the courts of appeals have expressed divergent views on whether there is a new value exception to the absolute priority rule. Before the Seventh Circuit's ruling here, the Ninth Circuit — in the case this Court agreed to review, but ultimately did not decide, in *Bonner Mall* — was the only court of appeals to have concluded that the new value exception continues to exist. *In re Bonner Mall Partnership*, 2 F.3d 899, 906-918 (9th Cir. 1993). See also *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986) (a pre-*Ahlers* decision, assuming without analysis that a new value exception exists).

But, as the Ninth Circuit recognized in *Bonner Mall*, other courts of appeals have taken different positions on whether there is a new value exception to the absolute priority rule. 2 F.3d at 901 ("dicta in several opinions demonstrate intra- and inter-circuit disagreements" on the question). See also *Coltex*, slip op. 7 (the "courts of appeal * * * have employed different reasoning to reach variable results"); 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c], at 1129-102 (L. King 15th ed. rev. 1997) ("One of the more hotly contested issues after adoption of the Code has been whether the so-called 'new value' cases continued to have validity. * * * [T]he circuits are currently in disarray.").

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[3] (...continued)
allowed debtor exclusivity while simultaneously maintaining that the debtor was receiving nothing of value "on account of" pre-petition interests, see Michael H. Strub, Jr., *Competition, Bargaining, and Exclusivity Under the New Value Rule: Applying the Single-Asset Paradigm of Bonner Mall*, 111 BANKING L.J. 228 (1994). See also Brief for the United States as Amicus Curiae at 25-30, *Bonner Mall* (No. 93-714).

In addition to the decisions of the Second and Fourth Circuits, a Fifth Circuit panel held flatly that the new value exception does not exist under the Bankruptcy Code. *In re Greystone III Joint Venture*, 995 F.2d 1274, 1282-1284 (5th Cir. 1991). The relevant portion of the opinion was later vacated by the panel, but Judge Jones (author of the panel opinion) vigorously dissented: "[I]n reaffirming what I wrote about the 'new value exception' in Part IV of the original opinion, * * * I would hope to stand with Galileo, who, rebuffed by a higher temporal authority, muttered under his breath, 'Eppur si muove.' ('And yet it moves.')." *Id.* at 1285. And, before the panel decision in this case, another Seventh Circuit panel strongly suggested, but did not decide, that the new value exception did not survive the codification of the absolute priority rule in 1978. *Kham & Nate's Shoes*, 908 F.2d at 1360-1362.

3. There is also a pronounced disagreement among district and bankruptcy courts concerning the new value exception. The Ninth Circuit noted in *Bonner Mall* that "[d]istrict and bankruptcy courts are sharply divided on the question * * *. The question will in all probability be decided by the Supreme Court." 2 F.3d at 901. The panel majority here echoed that observation: "The district and bankruptcy courts are quite divided over this issue." App., *infra*, 18a n.8. See also *Bryson*, 961 F.2d at 503 ("courts are divided as to whether codification of the absolute priority rule * * * tolled a death knell for the [new value] exception"); J. Ronald Trost, et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595, 677-699 (1997) (available on Westlaw) (collecting more than 100 published post-*Ahlers* decisions discussing whether a new value exception exists).

4. Bankruptcy scholars similarly dispute whether there is a new value exception to the absolute priority rule. See

App., *infra*, 18a n.8 ("[a]cademics and commentators, too, have not agreed on the issue") (citing articles on each side of the debate); *Bonner Mall*, 2 F.3d at 901 (commentators are "sharply divided on the question").[4] Many of the most thoughtful commentaries conclude — contrary to the Seventh Circuit here — that there is no such exception under the Code.[5] Others conclude — also inconsistently with the Seventh Circuit's position — that, if any such exception exists, it must not be applied so as to allow the debtor the *exclusive* right to infuse new equity.[6] The editors of one

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[4] See also, *e.g.*, Trost, et al., *supra*, SB37 ALI-ABA at 603 ("The viability of new value plans under the Code has been hotly debated by courts and commentators"); Jarlon Tsang, *The New Value Exception: Valuation Obstacles to the Absolute Priority Rule*, 14 ANN. REV. BANKING L. 361, 369 (1995) (the Court's decision in *Ahlers* "ignited judicial and academic debate on [an] issue already clouded with uncertainty"); Salvatore G. Gangemi & Stephen Bordanaro, *The New Value Exception: Square Peg in a Round Hole*, 1 AM. BANKR. INST. L. REV. 173, 179 (1993) (*Ahlers* "has caused extensive comment within the legal community and much division among lower courts"); Clifford S. Harris, Note, *A Rule Unvanquished: The New Value Exception to the Absolute Priority Rule*, 89 MICH. L. REV. 2301, 2312 (1991) ("A significant divergence of opinion concerning the viability of the new value rule has developed in the courts since *Ahlers*.").

[5] See, *e.g.*, Brian A. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 COM. L.J. 290 (1996); Lawrence B. Gutcho, *Real Estate Lenders and the Battle over "New Value,"* 110 BANKING L.J. 423 (1993); Julie L. Friedberg, Comment, *Wanted Dead or Alive: The New Value Exception to the Absolute Priority Rule*, 66 TEMPLE L. REV. 893 (1993).

[6] See, *e.g.*, Strub, *supra*, 111 BANKING L.J. 228; Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURVEY AM. (continued...)

treatise find the issue so close that they have reached opposite conclusions in consecutive revisions of the same edition. Compare 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c][iii], at 1129-117 to 1129-119 (L. King 15th ed. rev. 1997) (concluding that exception exists) with 5 COLLIER ON BANKRUPTCY ¶ 1129.03[e][i], at 1129-101 to 1129-102 (L. King 15th ed. 1996) (concluding that exception does not exist). This is manifestly an issue in need of resolution by this Court.

* * *

It has been nearly a decade since this Court left open the validity of the new value exception in *Ahlers*. After ten years of spirited debate, the federal courts and the commentators are in disarray on the issue. The differences are clear and well developed, and additional reflection by the lower courts is unlikely to result in a consensus view. It is time for this Court to resolve the question.

II. WHETHER THERE IS A NEW VALUE EXCEPTION TO THE ABSOLUTE PRIORITY RULE IS AN IMPORTANT AND RECURRING ISSUE

When this Court granted certiorari in *Bonner Mall*, it recognized the importance of deciding sooner rather than later whether the new value exception exists. Unfortunately, the parties' settlement left the Court unable to resolve the issue in that case. But it is just as true now as it was at the time of *Bonner Mall* that "[t]he 'new value' issue is perhaps the single most important bankruptcy law issue facing lenders today." Gutcho, *supra*, 110 BANKING L.J. at 423. "The split among and even within the circuits as to the viability of the exception has created unpredictability for debtors and the

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[6] (...continued)
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courts." Michelle Craig, Note & Comment, *The New Value Exception: A Plea for Modification or Elimination*, 11 BANKR. DEV. J. 781, 788 (1995). "Confusion over the absolute priority rule is deplorable, especially when the rule is fundamental to reorganization." Markell, *supra,* 44 STAN. L. REV. at 96.

It is particularly important that this Court rule on whether a new value exception exists because the question arises with such frequency in Chapter 11 proceedings. From the time this Court's decision in *Ahlers* first "caused a furor among lower courts," Markell, *supra*, 44 STAN. L. REV. at 95, until May 1997, federal courts published more than 100 decisions discussing the viability of a new value exception. See Trost, et al., *supra*, SB37 ALI-ABA at 677-699 (listing published rulings — the survey does not include unpublished decisions). The issue has also generated considerable scholarly debate. See *id.* at 672-676 (bibliography of relevant articles). "Few topics in bankruptcy have generated as much literature as the new value or fresh capital 'exception' to the absolute priority rule." Strub, *supra,* 111 BANKING L.J. at 233; see also, *e.g.*, Tsang, *supra,* 14 ANN. REV. BANKING L. at 363 ("the new value exception is one of the most actively debated issues in bankruptcy").

As suggested by the sheer number of judicial decisions and academic commentaries on the topic, whether there is a new value exception to the absolute priority rule is an issue of "enormous practical import." Strub, *supra,* 111 BANKING L.J. at 233. Indeed, "[t]he issue of new value is critical because the principles underlying this concept are at the very core of bankruptcy law and the notion of reorganization." David R. Kuney & Timothy R. Epp, *Aftermath of* Bonner Mall: *Evolution or Regression in the Notion of "New Value"?*, 5 J. BANKR. L. & PRAC. 211, 211 (1996).

"Negotiations are the lifeblood of a corporate reorganization," BAIRD, ELEMENTS OF BANKRUPTCY at 266,

and whether there is a new value exception will have a profound effect on the course of those negotiations. As the Ninth Circuit summarized in *Bonner Mall*, "[w]hether this doctrine is viable under the Bankruptcy Code has significant implications for the relative bargaining power of debtors and creditors in Chapter 11 cases." 2 F.3d at 901.

This is because the absolute priority rule, when "applied rigorously," acts as a "powerful brake on the debtor's behavior and a strong influence on the negotiation that is likely to occur over a reorganization plan" — it "make[s] the debtor more willing to negotiate" with creditors. DAVID G. EPSTEIN, STEVE H. NICKLES, & JAMES J. WHITE, BANKRUPTCY 839 (1993). If the absolute priority rule is watered down with a new value exception, there is a risk that the debtor's appraiser will convince "a sympathetic judge * * * that the value of the property in the bankruptcy estate is much lower than the creditors believe it to be." *Ibid.* See also BAIRD, ELEMENTS OF BANKRUPTCY at 266 ("the most serious danger that the new value exception introduces is that the judge will put a value on the firm that is too low"). This will decrease the amount paid to creditors, while at the same time permitting the debtor's pre-bankruptcy equity holders to retain an ownership interest in the post-bankruptcy business at a bargain price. EPSTEIN, ET AL., BANKRUPTCY at 839; BAIRD, ELEMENTS OF BANKRUPTCY at 262-263, 266. "The shareholders will be getting a good deal at the creditors' expense," *id.* at 266, or, at a minimum, will be able to impose a plan of reorganization that dissenting classes of senior creditors have concluded is not in their best interests. See *Greystone*, 995 F.2d at 1284-1285 (Jones, J., dissenting) ("Negotiations between creditors and the debtor against such a 'new value exception' backdrop would be enormously skewed in favor of old equity and would seriously erode the utility of the creditors' votes."). If, on the other hand, the absolute priority rule is "applied rigorously," each class of

creditors can protect itself against the possibility of a "small recovery" (or an otherwise unacceptable reorganization scheme) by "vetoing the plan." EPSTEIN, ET AL., BANKRUPTCY at 839.[7]

The "threat" of a new value plan "is often a powerful consideration at the negotiating table," Trost, et al., *supra*, SB37 ALI-ABA at 620, and thus the negotiations that occur in all Chapter 11 proceedings will be shaped largely by whether or not the absolute priority rule is limited by a new value exception. In the end, the identity of the constituency that will determine the ultimate outcome of Chapter 11 cases when the debtor is insolvent — senior, unsecured creditors or the debtor's pre-bankruptcy equity holders — will depend on the answer to the question presented in this case.

III. THE PANEL MAJORITY'S DECISION IS FUNDAMENTALLY FLAWED

In addition to being inconsistent with the decisions of other courts, the panel majority's holding is seriously flawed. The language enacted by Congress in 1978 does not contain a single reference to the new value exception. Congress was

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[7] In enacting the Bankruptcy Code, Congress intended to promote consensual plans, but at the same time maintain the integrity of the absolute priority rule. It did so by granting the debtor the exclusive initial right to propose a plan of reorganization, see 11 U.S.C. § 1121, but providing that a plan ultimately could not be confirmed without satisfying the absolute priority rule. Thus, Congress placed the initial bargaining leverage in the hands of the debtor through its initial exclusive right to propose a plan, but intended the *ultimate* leverage to be with the creditors pursuant to the absolute priority rule. See generally *Coltex*, slip op. 13 (discussing "the balance sought to be achieved by Congress" in Chapter 11). The decision of the panel majority eviscerates this congressional design by vesting both the initial and ultimate leverage in the debtor's pre-bankruptcy equity holders.

not silent on how it wanted the absolute priority rule applied: the plain terms of the statute list the ways in which a plan can be crammed down on unconsenting creditors, and the new value exception is not among them. There is still less basis for postulating congressional "silence" and interpreting it as tacit acceptance of well-settled doctrine. On the contrary, the exception rests on the shakiest of legal foundations: a dictum that had never been the basis for the holding of *any* reported decision before adoption of the Bankruptcy Code nearly 40 years later. What is more, the legal landscape that prompted the suggestion of a new value exception in 1939 is fundamentally different from the law of bankruptcy that exists today. Finally, the new value exception violates basic principles of bankruptcy law; it permits those at the bottom of the priority ladder to control the debtor's property to the detriment of impaired creditors with a higher priority.

A. The Plain Statutory Language Does Not Include A New Value Exception

The "cardinal canon" of statutory construction is that "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992). Thus, when a statute is unambiguous, judicial inquiry begins and ends with "the words of [the] statute." *Id.* at 254. In a case involving interpretation of the Bankruptcy Code, no less than any other statute, when "the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *United States* v. *Ron Pair Enterprises*, 489 U.S. 235, 241 (1989) (quoting *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917)).

The statute here is unambiguous. Section 1129(b)(2)(B)(ii) states that a plan that does not provide a dissenting class of unsecured creditors with property of a value equal to the amount of their claims *cannot* be confirmed unless "the holder of any claim or interest that is junior to the

claims of such class will not receive or retain under the plan on account of such junior claim or interest *any property*." (Emphasis added.) The language is unequivocal; it does not allow a junior class to receive "any" property "on account of" its pre-petition interest until senior classes are paid in full. Nor is there the slightest indication in the statute that the broad prohibition on the receipt of "any" property by junior classes is qualified by any type of exception. See *Bates* v. *United States*, 118 S. Ct. 285, 290 (1997) ("we ordinarily resist reading words or elements into a statute that do not appear on its face").

The court below, and other proponents of a new value exception, have attempted to find ambiguity in the statutory language through two devices. The first is the purest bootstrapping: because courts and commentators have differed about whether the new value exception exists, there *must* be ambiguity. See, *e.g.*, App., *infra*, 18a-19a. But that one-way ratchet, which renders the Bankruptcy Code more and more ambiguous whenever courts purport to find ambiguity in it leading to different constructions, is the path to interpretive chaos — not just in this case, but in every case involving any issue of even the slightest difficulty under the Code. Moreover, the approach cannot be reconciled with this Court's decisions. In *Ron Pair*, for example, the majority found the Code unambiguous even though four Justices thought that the better construction was the one rejected by the majority. As Judge Kanne rightly pointed out, *all* of this Court's bankruptcy decisions "command courts to apply a statute's unambiguous language without looking beyond it." *Id.* at 38a.[8]

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[8] The panel majority relied in part on the notion that past bankruptcy practice cannot be disregarded "absent a clear indication that Congress intended to break from those practices." App., *infra*, (continued...)

The second argument often advanced to try to fit the new value exception within the statutory language is that the equity holders' post-petition interest is not received or retained "on account of" their pre-petition interest but rather "on account of" the new value they contribute. See, *e.g.*, App., *infra*, 17a, 21a. That argument suffers from the flaw of assuming that there is an inconsistency between occurring "on account of" one thing and *also* occurring "on account of" something else. For example, Justices sit on this Court "on account of" their appointment by the President, but they also enjoy their positions "on account of" confirmation by the Senate. It would be absurd to claim that a Member of this Court does not hold his or her seat "on account of" presidential appointment merely because it is *also* true that senatorial

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[8] (...continued)
20a. But as the Second Circuit recognized in *Coltex*, slip op. 10, this Court has stressed that the unambiguous words of a statute must be applied even when the statute changes established pre-Code practice. See *Dewsnup* v. *Timm*, 502 U.S. 410, 419-420 (1992) ("Of course, where the language is unambiguous, silence in the legislative history cannot be controlling"); *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 495 U.S. 552, 560-564 (1990) (enforcing plain meaning of Bankruptcy Code provision even though it abrogated pre-Code practice). Applying the plain language of Section 1129(b) is particularly warranted here because there is no affirmative support in the Code's legislative history for the continued existence of the new value exception. See *Kham & Nate's Shoes*, 908 F.2d at 1361-1362. The complete absence of supporting legislative history distinguishes this case from *Dewsnup*, where there was legislative history indicating that Congress intended the pre-Code practice to survive. 502 U.S. at 419. See also *Union Bank* v. *Wolas*, 502 U.S. 151, 159 & n.14 (1991) (rejecting the argument that Congress intended to codify pre-Code law where the statute itself gave no such indication and the legislative history "does not even mention" the pre-Code practice).

confirmation is necessary. So too in this case, the equity holders enjoy their post-petition interest under the plan "on account of" *both* their prior equity positions and their promise to contribute new value — in contravention of the plain language of Section 1129(b)(2)(B)(ii).

That is especially clear in this case because the debtor's pre-petition equity holders were given the *exclusive* right to propose a plan involving their own new contributions. Whatever force the "on account of" argument might have when an auction of some sort is held (see *In re Homestead Partners, Ltd.*, 197 B.R. 706, 714-716 & n.9 (Bankr. N.D. Ga. 1996)),[9] it falls apart when the equity holders' pre-petition interest gives them the *exclusive* right to participate over creditor dissent by providing "new value." See *Coltex*, slip op. 14 (explaining that the new value exception permits insiders to obtain the debtor's property at a "bargain" price "untested by market forces").

As noted earlier, the right of the debtor's partners to retain their equity interests is "property" for purposes of this section. See pp. 9-10, *supra*. Moreover, this is "property" that is to be received or retained "on account of" the partners' pre-petition ownership in the debtor. On the facts of this case, they are receiving this *exclusive* opportunity *solely* "on account of" their prior equity interests in the debtor. Prior equity holders are the *only* persons permitted to make such an investment; other investors are barred from doing so. See App., *infra*, 34a (Kanne, J., dissenting); *Coltex*, slip op. 9-11; *Bryson*, 961 F.2d at 504-505; *Greystone*, 995 F.2d at 1283, 1285 (Jones, J., dissenting).

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[9] For a fuller listing of cases suggesting an auction "solution," see Trost, et al., *supra*, SB37 ALI-ABA at 651-652 & nn.208-211, 658 & nn.242-243, 666-667 & nn.281-293.

Had Congress wanted to include a new value exception in the Bankruptcy Code, it could have done so easily. It did not. See Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 536 (1947) (in interpreting a statute, "[o]ne must * * * listen attentively to what it does *not* say") (emphasis added).[10] As enacted, the Code "strikes a considered balance between creditor and debtor interests, which creditors, debtors, and courts must scrupulously respect." *Coltex*, slip op. 13. Courts "must enforce the statute according to its terms," *Patterson* v. *Shumate*, 504 U.S. 753, 759 (1992), and by its terms, the Bankruptcy Code simply does not include a new value exception to the absolute priority rule — certainly not one broad enough to allow the pre-petition equity holders to enjoy the exclusive right to contribute new value that they were accorded here.

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[10] Having made no mention of any new value exception in the statute, Congress, of course, provided no guidance as to the content of any such exception. Any such development, therefore, must occur entirely in the courts. But Congress knows how to say when it intends such judicial development of the content of a Bankruptcy Code provision. See, *e.g.*, 124 Cong. Rec. H11095 (daily ed. Sept. 28, 1978) ("It is intended that the in term 'principles of equitable subordination' [in 11 U.S.C. § 510(c)] follow existing case law and leave to the courts development of this principle"); *id.* at S17412 (daily ed. Oct. 6, 1978) (same). That Congress did not do so here reinforces the conclusion that it intended the codified absolute priority rule to be enforced as written, not to be subject to an exception — uncodified and unmentioned in the legislative history — to be developed by the courts.

B. Congress Did Not Adopt The New Value Exception *Sub Silentio* When It Enacted The Bankruptcy Code In 1978

The panel majority's decision rested on its belief that this Court "established" the new value exception in 1939, and that when Congress enacted the Bankruptcy Code nearly 40 years later, it "must have" done so with a "full understanding" of this doctrine, which "has long been ensconced in our bankruptcy practice." App., *infra*, 14a, 20a. None of the panel majority's premises is correct.

1. This Court has never "established" a new value exception. The exception is rooted in dicta found in Justice Douglas's opinion for the Court in *Case* v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 121-122 (1939). But the Court has never adopted those dicta as the basis for the holding in any case; as Judge Easterbrook has noted, "[s]o far as the Supreme Court is concerned," the development of the new value exception "has been 100% dicta." *Kham & Nate's Shoes*, 908 F.2d at 1360.[11]

2. Nor was the doctrine "established" in the lower courts before 1978. As the Second Circuit and Judge Kanne have noted, *Coltex*, slip op. 11; App., *infra*, 42a n.5, before Congress adopted the Bankruptcy Code in 1978, "*no* reported case seems to have adopted Justice Douglas' dicta as its holding," Markell, *supra*, 44 STAN. L. REV. at 92 (emphasis added). Accord, *e.g.*, Ayer, *supra*, 87 MICH. L. REV. at 1016 ("Justice Douglas' supposed 'exception' * * * is

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[11] Moreover, it is generally understood that the *Case* dicta themselves are "based on a misunderstanding of earlier law." BAIRD, ELEMENTS OF BANKRUPTCY at 263. See also App., *infra*, 41a; *Kham & Nate's Shoes*, 908 F.2d at 1360-1361; EPSTEIN, ET AL., BANKRUPTCY at 841-843; John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963, 999-1007 (1989).

nowhere present as a rule of decision in Chapter X cases [under the prior statute, the Bankruptcy Act of 1898]. New value under Chapter X, then, is an illusion."); Tsang, *supra*, 14 ANN. REV. BANKING L. at 368 ("Prior to the revisions of the Code, the new value exception espoused in *Case* had appeared in no reported cases. After * * * 1978, litigation over the existence and application of the new value exception exploded in the lower courts."). In short, at the time Congress enacted the Bankruptcy Code, the *Case* dicta were "seemingly moribund." 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c][i][A], at 1129-108. Given the absence of any reported decision before 1978 purporting to apply the exception, the panel majority's statement that "the new value exception traditionally has played" a "major role * * * in the bankruptcy field," App., *infra*, 20a, is dubious at best.[12]

3. In addition to the fact that *Case*'s remarks about new value were dicta, not a holding, and that no published decision had ever adopted those dicta as the basis for a holding in the ensuing 40 years, there is another reason why congressional "silence" on the new value exception in enacting the Bankruptcy Code cannot be taken as tacit acquiescence of the exception. The bankruptcy scheme that existed in 1939 — and that prompted the *Case* dicta — was vastly different from the Bankruptcy Code adopted in 1978.

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[12] Since *Ahlers* began the current furor over new value, very few new value plans have actually been confirmed, but the vast majority of those that have been confirmed — including the plan in the present case — have been confirmed very recently. See Trost, et al., *supra*, SP[illegible] ALI-ABA at 619 & n.77, 644 & n.174. Thus, ironically, the [illegible]kruptcy Code, whose language and structure are far more inhospitable to any new value exception than pre-Code law, is being construed to allow *greater* practical opportunities to buy into a reorganized business over creditors' objections than the prior law.

Before enactment of the Bankruptcy Code, bankruptcy proceedings had been governed by the Bankruptcy Act of 1898, which contained three rehabilitative chapters, Chapters X, XI, and XII. Each chapter differed from the others with respect to the standards that had to be met in order to confirm a plan over a dissenting class of unsecured claims, commonly known as "cramdown." Chapter X (and its predecessor, Section 77B) authorized a court to approve a plan only if it was "fair and equitable," but the statute did not define that phrase. *Case*, 308 U.S. at 114-115. Chapter X also required *unanimous* consent of all creditors to confirm a plan. *Ibid.* It was against this backdrop, in the course of elucidating the meaning of the "fair and equitable" requirement, that Justice Douglas suggested that there might be a judicially created exception to the absolute priority rule. *Id.* at 114-121.

Two other rehabilitative chapters also existed before adoption of the Bankruptcy Code. Under Chapter XI, as amended in 1952, there was no "fair and equitable" requirement; thus, "the absolute priority rule did not apply in Chapter XI proceedings," and new value issues "never arose." Markell, *supra*, 44 STAN. L. REV. at 92 & n.152. Chapter XII, which dealt with real estate reorganizations, also "did not require that a plan conform to the absolute priority rule" after the statute was amended in 1952, and thus new value was not an issue under Chapter XII either. Gangemi & Bordanaro, *supra*, 1 AM. BANKR. INST. L. REV. at 188 & n.106.

When Congress enacted the Bankruptcy Code in 1978, it "radically altered reorganization strategy," Markell, *supra*, 44 STAN. L. REV. at 123, in ways that removed any need or basis for the new value exception proposed in *Case*. Congress replaced three disparate statutory schemes with a single one, Chapter 11. The statute no longer required unanimous class consent to confirm a plan, 11 U.S.C. § 1126(c), and the "fair and equitable" test applied only if class acceptance did not

occur, 11 U.S.C. § 1129(b)(1). These changes mean that, if *Case* arose today, a new value exception would not be needed to ensure continued shareholder control; the vote in that case — approval by more than 90% of each class of creditors, 308 U.S. at 111-112 — would satisfy Section 1126(c) of the current Code. BAIRD, ELEMENTS OF BANKRUPTCY at 262. Finally, the Code — unlike Chapter X — includes an elaborate definition of the "fair and equitable" standard. 11 U.S.C. § 1129(b)(2). Nothing in that definition, however, mirrors the new value dictum articulated in *Case*.

These features of Chapter 11 "represent[] a significant change from pre-Code bankruptcy law and arguably render[] the new value exception unnecessary." App., *infra*, 43a (Kanne, J., dissenting); see also *Greystone*, 995 F.2d at 1282, 1285 (Jones, J., dissenting); EPSTEIN, ET AL., BANKRUPTCY at 844-845. In fact, as Judge Kanne concluded, "cutting and pasting pre-Code practice into a fundamentally different bankruptcy context" results in a "new" statute "that Congress likely never intended." App., *infra*, 46a; see also *Coltex*, slip op. 11-13. In light of the dramatic changes made in 1978 to the statutory framework for business reorganizations, there is no basis for concluding that Congress meant to continue the use of a doctrine founded on dicta written in a significantly different legal environment — particularly when those dicta had never been followed in the four ensuing decades. See *Wolas*, 502 U.S. at 160 (given the "substantial changes in the preference provision, there is no reason to assume" that pre-Code rules should apply under the 1978 Code).

C. A New Value Exception Would Be Inconsistent With The Policies Underlying The Bankruptcy Code

Besides having no basis in the statutory text, the new value exception adopted by the Seventh Circuit is inconsistent with basic Bankruptcy Code principles. To begin with, a new value exception would turn the bankruptcy priority scheme on

its head. The exception not only permits prior equity holders to participate in the reorganized entity, but it gives the parties in interest with the *lowest* legal priority the ultimate right to control a debtor and its property, even if their pre-petition economic position in the debtor has become valueless and senior, unsecured creditors will not receive payment in full of their claims. Cf. *CFTC* v. *Weintraub*, 471 U.S. 343, 355 (1985) ("One of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors").

This is contrary to a fundamental precept of the Bankruptcy Code. "Creditors effectively own bankrupt firms," *Kham & Nate's Shoes*, 908 F.2d at 1360, and "the Code provides that it is up to the creditors — and not the courts — to accept or reject a reorganization plan which fails to provide them adequate protection or fails to honor the absolute priority rule," *Ahlers*, 485 U.S. at 207. See also *Greystone*, 995 F.2d at 1283-1285 (Jones, J., dissenting). The new value exception reverses the roles of creditors and courts. It "means a power in the judge to 'sell' stock to the managers even when the creditors believe that this transaction will not augment the value of the firm," *Kham & Nate's Shoes*, 908 F.2d at 1360, or otherwise be in their best interests. See also *Coltex*, slip op. 17 (approving a new value plan "for the benefit of insiders" would stymie a creditor "in its legitimate attempts to obtain the value of its claims"). And because of the deferential standard of review, "each bankruptcy court can impose its freewheeling view of reorganization policy without fear of appellate reversal." *Greystone*, 995 F.2d at 1284-1285 (Jones, J., dissenting). The Code does not give bankruptcy judges this power.

As applied in this and many similar cases involving debtor exclusivity, moreover, the new value exception permits the debtor's insiders effectively to sell the debtor's property to themselves on their own chosen terms. The only check on

abuse of that power is a bankruptcy judge's necessarily imperfect attempt at valuation — rather than the market discipline that would be provided if there were competitive bids from creditors or outsiders. See *Coltex*, slip op. 12 (noting the danger of "self-dealing"). No provision in Chapter 11 of the Code permits this type of self-interested conduct by the debtor's owners. See *In re A.V.B.I., Inc.*, 143 B.R. 738, 747 (Bankr. C.D. Cal. 1992). Indeed, case law under 11 U.S.C. § 363, the principal Code provision governing the sale of assets, flatly prohibits such closed, insider-only sales. *E.g.*, *In re W.A. Mallory Co.*, 214 B.R. 834, 838 (Bankr. E.D. Va. 1997).

The panel majority speculated, without citation, that the new value exception "has been a major source of new funding in reorganizations for the past fifty years" and that the absence of a new value exception might threaten "the continued existence[] of many corporate entities." App., *infra*, 21a. On its face, this is a questionable proposition, given that there are *no* reported cases before 1978 approving a plan of reorganization incorporating the new value exception. In any event, the absolute priority rule does not bar prior equity holders from providing new capital; it only prohibits the pre-bankruptcy shareholders from having the exclusive or prior option of retaining control of the reorganized business *over the objections of a senior class of impaired unsecured creditors*. Creditors will *consent* to a plan that involves an infusion of new value when, in their estimation, it truly is in the best interests of creditors and the estate. See *Kham & Nate's Shoes*, 908 F.2d at 1360; Basil, *supra*, 101 COM. L.J. at 303-304 & n.83. The true policy issue in new value cases is not whether old equity can participate by contributing new value, but whether *a bankruptcy judge* should be able to *force* creditors to

participate in such a plan by telling them that they have misperceived their own best interests.[13]

Finally, even if pre-bankruptcy equity holders were a significant source of reorganization funding in 1939, when the country was not yet out of the Depression, today's capital markets make it much easier for worthwhile ventures to obtain financing. See Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. CHI. L. REV. 651, 672 (1974) ("Current data do not support the belief that old shareholders are a fruitful source of additional funds when the public capital markets are unlikely to provide funds. In recent years shareholders have seldom contributed new capital"). The inability of a reorganized company to convince anyone other than a pre-petition equity holder to lend it money today suggests not a failure of the capital markets as much as a realistic assessment that the reorganization is not likely to succeed.

At bottom, the panel majority's decision is contrary to the principal underlying premise of equity ownership in an enterprise: in exchange for its greater potential for return, equity takes the greater risk of loss. See Basil, *supra*, 101 COM. L.J. at 302-303. It is antithetical to the principles underlying the absolute priority rule to permit a debtor's equity holders, who would have kept all of the profits in the enterprise had there been any, to shift the risk of loss to a senior class of creditors when business turns sour.

CONCLUSION

The petition for a writ of certiorari should be granted.

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[13] In fact, as Dean Baird has pointed out, the new value exception is a one-way ratchet allowing equity holders first to see whether a judge undervalues the firm and only then to commit themselves to invest in it. BAIRD, THE ELEMENTS OF BANKRUPTCY at 262-263.

Respectfully submitted.

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February 1998

APPENDIX

APPENDIX A

In the
United States Court of Appeals
for the Seventh Circuit

NOS. 96-2137 & 96-2138

IN THE MATTER OF:

203 N. LASALLE STREET PARTNERSHIP,
an Illinois Limited Partnership,

Debtor-Appellee,

APPEAL OF:

BANK OF AMERICA ILLINOIS,

Appellant.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.
Nos. 95 C 7144 & 96 C 238—**Paul E. Plunkett**, *Judge.*

ARGUED NOVEMBER 6, 1996—DECIDED SEPTEMBER 29, 1997

Before CUMMINGS, RIPPLE and KANNE, *Circuit Judges.*

RIPPLE, *Circuit Judge*. This case involves Bank of America Illinois' ("Bank America") appeal of the confirmation of a bankruptcy reorganization plan. 203 N. LaSalle Street Limited Partnership ("LaSalle"), which owns fifteen floors of office space in a Chicago building, failed to pay a secured note held by Bank America, and Bank America attempted to foreclose on the property. LaSalle filed for bankruptcy under Chapter 11, 11 U.S.C. § 1101 *et seq.* LaSalle eventually filed a reorganization plan that the bankruptcy court approved, as modified, despite Bank America's opposition to the plan. The district court upheld the bankruptcy court's order confirming the plan. For the reasons set forth in the following opinion, we affirm the judgment of the district court.

I

BACKGROUND

A. *Facts*

The debtor in this case, LaSalle, is an Illinois limited partnership that owns fifteen floors of office space in a building in the central business district of Chicago. The property was encumbered by a lien in favor of Bank America; LaSalle owed Bank America more than $93 million. LaSalle's loan was secured by a first non-recourse mortgage on the property that came due on January 3, 1995. LaSalle was unable to repay the loan, so Bank America started a foreclosure action in state court on January 20, 1995. In response, LaSalle filed for bankruptcy under Chapter 11. Bank America elected to have its secured claim, which was significantly greater than the value of the security, treated as a secured claim and an unsecured claim under 11 U.S.C.

§ 1111(b).[1] In addition to the debt held by Bank America, LaSalle had several other debts outstanding: One of the general partners held a second non-recourse mortgage on the property; $2.3 million in real estate taxes remained unpaid; and other non-inside creditors held $90,000 in trade claims.[2] In addition to the property, LaSalle held the right to a cash account consisting of pre-petition rents that amounted to $3.1 million. By filing for bankruptcy rather than having Bank America foreclose on the property, LaSalle's partners postpone significant tax liabilities estimated at $20 million.

Before the bankruptcy court, the debtor filed a plan for reorganization on April 13, 1995, which it amended on May 12. Bank America objected to the amended plan, and the bankruptcy court rejected it because, in the court's view, the plan was not feasible. LaSalle further revised the plan and filed another reorganization plan on September 11, 1995. Under the new plan, Bank America was the only party to object, and at least one impaired class of claims, the unsecured trade debt class, voted to approve the plan. The bankruptcy court conducted a hearing and confirmed the plan

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[1] *See In re Woodbrook Assocs.*, 19 F.3d 312, 317 n.2 (7th Cir. 1994). In a Chapter 11 bankruptcy proceeding, a secured creditor, in most situations, may elect how his claim is treated. Lawrence P. King, Collier on Bankruptcy ¶ 1103[1] (15th rev. ed. 1997). A creditor with a lien on the debtor's property may elect either to continue to have its debt secured by the property in its full amount or to separate its claim in two: a secured claim in the amount of the value of the property and an unsecured claim for the deficiency amount. *See* 11 U.S.C. §§ 506(a), 1111(b). Bank America has chosen this latter course.

[2] LaSalle originally owed $160,000 in unsecured trade debt, but after filing for bankruptcy, the general partners purchased some of the trade claims.

(with slight modification).[3] In its thorough opinion, the bankruptcy court found that the plan met all of the necessary requirements under 11 U.S.C. § 1129. It therefore confirmed the plan, finding the value of the property at that time to be $55.8 million.

Under the confirmed plan, the debtor's partners would contribute new capital: $3 million the day after the effective date of the plan and five annual installments of $625,000 thereafter. LaSalle would pay the non-insider trade creditors in full without interest. Upon confirmation, the insiders would waive their general unsecured claims. The priority and state tax claims under the plan would be paid within 30 days of approval. Bank America's secured claim ($54.5 million)[4] would be paid partly in cash, $1.1 million within 5 days of the effective date of the plan, and the rest as a 7-10 year interest-bearing note secured by the property. Monthly payments would be made on a 30-year amortization schedule, and any excess payments would be applied to the principal. At the end of that time, if the property were sold or refinanced, any additional proceeds, after the secured claim

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[3] The plan originally called for paying the trade claims 180 days after confirmation of the plan; the bankruptcy court confirmed the plan on the condition that LaSalle also agree to pay interest to the trade creditors on the principal amounts for the 180 days following confirmation.

[4] The bankruptcy reduced the value of the property at the time of confirmation, $55.8 million, by the amount that it would have cost Bank America to dispose of the property, $1.3 million, and arrived at a value of Bank America's secured loan in the amount of $54.5 million. Bank America also has an unsecured claim for the amount of the deficiency, the difference between its secured claim and the total amount that LaSalle owed the bank. Bank America's deficiency claim is for approximately $38.5 million.

is paid, would be applied toward Bank America's unsecured claim, $38.5 million. The plan also provided that, in the case of default, the debtor's deed held in escrow would be conveyed to Bank America.

B. *District Court Proceeding*

Bank America appealed the bankruptcy court's confirmation of LaSalle's reorganization plan to the district court and raised 14 objections. The district court reviewed Bank America's objections and upheld the decision of the bankruptcy court in its entirety. The district court rejected Bank America's objection that the plan was not proposed in good faith, as required by § 1129(a)(3), because that provision focuses on the content and effect of the plan, not the subjective motivation of the plan's proponent. The court further reasoned that, even if § 1129(a)(3) were concerned with the filer's motivation, here the avoidance of tax consequences, LaSalle's proposal was not filed in bad faith. The district court also found that the bankruptcy court's factual findings that the plan was accepted by an actual impaired class, as required by § 1129(a)(10), was not clearly erroneous. The district court agreed with the bankruptcy court that the plan met § 1129(a)(7)(A)'s "best interest" test because, under the proposed plan, Bank America receives property of a value not less than the amount Bank America would receive if the debtor had proceeded under Chapter 7: The present value of the plan for the secured claim is the same under the plan as Bank America would receive in a Chapter 7 liquidation. In addition, Bank America's deficiency claim, its unsecured claim, is treated more favorably under the proposed plan than under Chapter 7 because, under Chapter 7, Bank America would have received nothing for its unsecured deficiency claim. Further, according to the court, because the best interest test is met and the plan is carefully tailored to fulfill the requirements of

that test, the plan does not unfairly discriminate against Bank America. Indeed, said the court, the discrimination from which Bank America claimed to suffer—other unsecured claims are paid off 100%, but Bank America gets only 16% of its unsecured claim—is not unfair. The district court agreed with the bankruptcy court that the Bankruptcy Code did not abolish the Bankruptcy Act's "new value" corollary to the absolute priority rule. In addition, the district court agreed with the bankruptcy court that the requirements for the new value corollary were met in this case. Therefore, the court found, the property held by the partners under the proposed plan did not violate the absolute priority rule. The court also upheld the bankruptcy court's determination that, despite the potential cash shortfalls in years 7 and 8 of the plan, the plan was feasible. Finally, the district court upheld the bankruptcy court's finding that the plan was fair and equitable in its treatment of Bank America's unsecured claim; the plan therefore met § 1129(b)(2)'s "cramdown" requirements. The district court, in short, upheld the bankruptcy court in toto, and Bank America appeals.

II

DISCUSSION

For a reorganization plan to be confirmed, the plan must meet the requirements of 11 U.S.C. § 1129.[5] Bank America

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[5] Section 1129 provides in relevant part:

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(continued...)

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[5] (...continued)

. . . .

(3) The plan has been proposed in good faith and not by any means forbidden by law.

. . . .

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

. . . .

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by an insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

. . . .

(b)(1). . . [I]f all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan . . . if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

. . . .

(B) With respect to a class of unsecured claims—

. . . .

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive

(continued...)

makes many of the same arguments to us that it did on appeal to the district court. Bank America alleges that the plan should not have been confirmed because it did not meet a number of § 1129's requirements. Success on the merits of any one of these claims would dictate a reversal of the bankruptcy court's confirmation order, unless, as LaSalle maintains, the appeal is moot. We shall deal with each of these issues in turn.

However, before we turn to the specifics of the case, a quick overview of the process for the confirmation of a reorganization plan may prove useful. For a bankruptcy court to approve a proposed reorganization plan, the plan's proponent must show that the plan satisfies the 13 requirements of § 1129(a), if they are applicable. With one exception, to be discussed, a plan must meet all 13 requirements. They are: (1) the plan's compliance with Title 11, (2) the proponent's compliance with Title 11, (3) the good faith proposal of the plan, (4) the disclosure of payments, (5) the identification of management, (6) the regulatory approval of rate changes, if applicable, (7) the "best interest" test, (8) the unanimous acceptance by impaired classes, (9) the treatment of administrative and priority claims, (10) the acceptance by at least one impaired class of claims, (11) the feasibility of the plan, (12) the bankruptcy fees, and (13) retiree benefits. *See* 11 U.S.C. § 1129(a)(l)-(13). If, however, a plan is not approved by all of the impaired classes, as generally required by 11 U.S.C. § 1129(a)(8), it is still possible for a plan to be confirmed. If at least one of the non-insider, impaired classes of claims

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[5] (...continued)

> or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129.

approves the plan, then a plan may be confirmed if two additional requirements are met. *See* 11 U.S.C. § 1129(b). If the bankruptcy court finds that all of the applicable requirements of § 1129(a) are met except for § 1129(a)(8), and also that the plan does not discriminate unfairly between impaired classes and is fair and equitable to the rejecting classes, then the court may confirm the plan. *See* 11 U.S.C. § 1129(b)(1)-(2).

In our review of the district court and bankruptcy court decisions, we review both courts' conclusions of law de novo. *In re Chappell*, 984 F.2d 775, 779 (7th Cir.1993). We review the determinations of fact by the bankruptcy court for clear error. *In re Andreuccetti*, 975 F.2d 413, 419-20 (7th Cir. 1992). A "'finding is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.'" *FDIC v. Bierman*, 2 F.3d 1424, 1431 (7th Cir. 1993) (quoting *Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985)) (internal quotation and citation omitted).

A. *Mootness*

As a preliminary matter, we must respond to LaSalle's contention that the appeal should be dismissed as moot. LaSalle submits that, because the reorganization plan has been confirmed and LaSalle has implemented the plan, it would be very difficult now to reverse all the necessary transactions without harming a number of innocent third parties. Specifically, LaSalle contends: Investors have already put their capital into the reorganized debtor (thus foregoing other investment opportunities); LaSalle has renegotiated a lease with one of its two largest tenants; that tenant has spent a significant amount of money to redecorate its leased space; and numerous other payments have been made. In short,

LaSalle concludes, under the circumstances, it would be very difficult for the bankruptcy court to "unscramble the eggs" now.

The mere fact that Bank America was unable to obtain a stay from either the district court or this court does not necessarily lead to the conclusion that, once the plan has been confirmed and implemented, all issues related to the confirmation of the plan are moot. *See In re Envirodyne Indus.*, 29 F.3d 301, 303-04 (7th Cir. 1994); *In re Andreuccetti*, 975 F.2d at 418. In *In re Envirodyne*, we held that a court's ability to provide at least partial relief satisfies the Article III mootness issue. 29 F.3d at 303-04. With respect to the principle that courts will frequently refuse to modify a bankruptcy plan if it has already been implemented (formerly known as the "equitable mootness" doctrine), we noted that our inquiry is "whether modification of the plan of reorganization would bear unduly on the innocent." *Id.* at 304; *cf. In re Lloyd*, 37 F.3d 271, 273 (7th Cir. 1994) (holding in bankruptcy proceeding that, because court could fashion some relief for the debtor, appeal was not moot, despite estate's sale of property to good faith purchaser). "So if modification of a plan of reorganization would upset legitimate expectations, it *may* be refused . . . ." *In re Envirodyne*, 29 F.3d at 304 (emphasis added).

Many of the transactions that have occurred to date easily can be reversed without significant harm to third parties. Bank America seeks to foreclose on the property; doing so would not affect the monies that the trade creditors and state taxing authority have received. Bank America also does not seek to reverse the lease agreement reached between LaSalle and its tenant. Moreover, Bank America has agreed to return any payments and documents to LaSalle necessary to reverse the transaction. Finally, Bank America has consented to repay to the investors their investments plus reasonable

interest. We believe that, if we were to reverse the decisions of the district and bankruptcy courts, the bankruptcy court could fashion some form of relief that would not unduly burden innocent third parties. Therefore we, like the district court, do not agree with LaSalle that the appeal is moot.

B. *Feasibility*

Bank America insists that the plan fails to meet the feasibility requirement of § 1129(a)(11), which requires that, in order for a plan to be confirmed, the "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization of the debtor . . . ." 11 U.S.C. § 1129(a)(11). In determining that the plan was feasible, the bankruptcy court need not find that it is guaranteed to succeed; "[o]nly a reasonable assurance of commercial viability is required." *In re T-H New Orleans Ltd. Partnership*, 116 F.3d 790, 801 (5th Cir. 1997) (brackets in original); *accord In re Acequia, Inc.*, 787 F.2d 1352, 1364 (9th Cir. 1986); *In re Monnier Bros.*, 755 F.2d 1336, 1341 (8th Cir. 1985). Bank America, in arguing that the plan will not succeed, focuses on years 7 and 8 of the plan. In those years, LaSalle expects that it will experience cashflow shortfalls.

The bankruptcy court scrutinized the plan very carefully and, despite these shortfalls, determined that the plan was feasible. It reasoned that the cashflow under the plan would be sufficient to pay all the debtor's expenses and the debt service to the bank for the first six years of the plan. By that time, the bankruptcy court concluded, LaSalle will have paid down the principal on the note by $7.5 million. In years 7 and 8 of the plan, however, there will be some cashflow shortages because of likely costs expended to renew the lease of one of the major tenants in the property. In years 9 and 10, the court predicted, projected cashflow will again exceed

expenses and debt service. This cashflow shortfall would not make the plan unfeasible, stated the court, because it was likely that, after six years of successful implementation of the plan, Bank America voluntarily would lend the needed capital to LaSalle. If, on the other hand, the bank at that time decided not to lend LaSalle the money, LaSalle could sell its interest in the property and prepay the balance of the loan. The bankruptcy court, after hearing expert testimony on the improving market for office space in Chicago's central business district, determined that, at the time of the cashflow shortfall, the value of LaSalle's property would significantly exceed the remaining principal on the secured debt. Alternatively, the court found that, even if LaSalle did not make up the shortfall, there would not be a liquidation. Under the plan, if Bank America refuses to lend LaSalle the necessary capital and LaSalle does not sell its property, LaSalle will automatically and voluntarily transfer the property to Bank America.

Bank America forwards three points that, it insists, undermine the bankruptcy court's conclusion that the plan is feasible. First, Bank America argues that the success of the plan depends upon the bank's willingness to re-lend money to LaSalle. Second, Bank America contends that, although there was expert testimony on which the court relied about the improving real estate market in the central business market in general, there was no testimony of an improving market for this specific property. Finally, Bank America asserts that the automatic reconveyance of the property to the bank in the event of LaSalle's default does not sufficiently protect Bank America's interest because a potential future bankruptcy proceeding could invalidate the conveyance.

We agree with the district court, which, when considering the same arguments on appeal, concluded that these concerns are "primarily hypothetical, and constitute

merely disagreements with the inferences drawn by the bankruptcy court." *In re 203 N. LaSalle St. Ltd. Partnership*, 195 B.R. 692, 710 (N.D. Ill. 1996). Contrary to Bank America's assertions, the bankruptcy court did not conclude that the success of the plan required Bank America to re-lend LaSalle capital in years 7 and 8 of the plan, although the court concluded that such a transaction would be the most likely outcome. Instead, the court considered alternatives that would not violate the § 1129(a)(11) requirement even if Bank America were not to re-lend capital to LaSalle. We do not think that the bankruptcy court's conclusion on this point is clearly erroneous. We also do not believe that the inference the bankruptcy court drew about the future marketability of LaSalle's property by relying on expert testimony concerning the future real estate market in the property's vicinity, rather than requiring expert predictions with respect to the future market solely for LaSalle's property, was clearly erroneous. A plan need not be assured of success to be confirmed. We cannot accept Bank America's submission that the bankruptcy court's decision on this point was clearly erroneous.

C. *New Value Corollary*

1.

The general rule for a reorganization plan that has not been approved unanimously by the impaired classes is that it must meet the strictures of the absolute priority rule to be approved.[6] The Supreme Court of the United States has

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[6] The absolute priority rule derives from § 1129's "fair and equitable" requirement. *See In re Snyder*, 967 F.2d 1126, 1128 (7th Cir. 1992) (tracing the absolute priority rule, conceptually, at least as far back as *Northern Pac. Ry. v. Boyd*, 228 U.S. 482

(continued...)

summarized the absolute priority rule as follows: "[A] dissenting class of unsecured creditors must be provided for in full before any junior classes can receive or retain any property under a reorganization plan." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) (internal quotation and brackets omitted).

Prior to the passage of the Bankruptcy Code, there was a corollary to this rule, the "new value" corollary. *See In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1314 (7th Cir. 1995), *cert. denied*, 117 S.Ct. 389 (1996). Under the new value corollary, established by *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), a junior claim holder (an equity interest holder, for example) may retain, in some circumstances, his equity interest in the property over the objection of a senior impaired creditor class. To do so, the junior interest holder, under the proposed plan, must contribute new capital to the restructured enterprise. That capital must be new, substantial, necessary for the success of the plan, reasonably equivalent to the value retained, and in the form of money or money's worth. *In re Woodbrook Assocs.*, 19 F.3d 312, 319-20 (7th Cir. 1994). The Supreme Court has noted that this corollary is rooted in the pragmatic realization that, in the course of a reorganization, "additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them, unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them." *Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).

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[6] (...continued)
(1913)); King, Collier on Bankruptcy ¶ 1129.04, at 1129-82 (tracing the rule back to *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939)).

In enacting the Code, Congress codified the absolute priority rule, § 1129(b)(2)(B)(ii), by providing that a plan's treatment of the creditors would be fair and equitable if

> the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan *on account of* such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added). At the same time, the Code altered the scheme of plan confirmation to provide that a plan could be confirmed if at least one of the impaired non-insider classes of creditors votes to approve the plan. The court then must confirm the plan if it finds that the plan does not discriminate unfairly and is "fair and equitable" to each dissenting class. *See* 11 U.S.C. § 1129(b)(2).

At the time it codified the absolute priority rule, Congress did not explicitly codify the new value corollary. *In re Woodbrook*, 19 F.3d at 320. Neither we nor the Supreme Court has had occasion to determine definitively whether this new value exception survived passage of the Bankruptcy Code. *See In re Wabash*, 72 F.3d at 1315.[7]

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[7] Although the question of whether the new value corollary survived Congress' passage of the Bankruptcy Code has not been determined definitively in this circuit, we have considered it on several occasions without deciding the issue. *See, e.g., In re Wabash; In re Woodbrook; In re Snyder*, 967 F.2d 1126, 1130 (7th Cir. 1992); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990); *In re Stegall*, 865 F.2d 140 (7th Cir. 1989). Our previous opinions have provided conflicting, albeit tentative, suggestions on the directions that we might take. We have intimated on occasion that the passage of the Bankruptcy Code has left the new value corollary intact. *See In re*
(continued...)

Both the bankruptcy court and the district court concluded that the new value corollary did survive passage of the Code. Based upon its conclusion, the bankruptcy court determined that LaSalle's plan did not violate § 1129(b)(2)'s absolute priority rule because LaSalle's plan met the requirements of the new value corollary. Bank America contends that the courts erred on both counts: First, the new value exception is no longer viable; second, even if still valid, LaSalle's plan did not meet the requirements of the exception.

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[7] (...continued)
Woodbrook, 19 F.3d at 320 ("The current trend is to treat the new value precept not as an exception (as it was commonly called) but as a corollary to the absolute priority rule preserved in the 1978 Code."); *In re Snyder*, 967 F.2d at 1129 (concluding after significant discussion that "[t]here is nothing in either the text or the legislative history of § 1129(b) that can be said to demonstrate a clear intent to modify seventy-five years of judicial construction of the absolute priority doctrine or its new value exception"); *cf. In re Potter Material Serv., Inc.*, 781 F.2d 99, 101-04 (7th Cir. 1986) (applying new value corollary without discussion of whether exception survived the Code). *But see In re Stegall*, 865 F.2d 140, 142 (7th Cir. 1989) (noting that question was open, despite *In re Potter*). On the other hand, we have indicated that the new value exception might have been abolished by the codification of the absolute priority rule without also incorporating the new value exception. Such a course would result in a holding that the absolute priority rule is absolute: There is no new value exception after the passage of the Bankruptcy Code. *See Kham & Nate's Shoes*, 908 F.2d at 1360-61 (characterizing the new value exception as judicial dicta and noting that the language of the Code and legislative history suggest that the exception vanished in 1978). We note that the panel in *Kham & Nate's Shoes* did not have the benefit of the Supreme Court of the United States' opinion in *Dewsnup v. Timm*, 502 U.S. 410 (1992). As we explain below, *Dewsnup* is instructive on this issue.

We begin, as we must with every statutory interpretation question, with the wording of the statute. Bank America reads § 1129(b)(2)(B)(ii) to require, by the very force of the language itself, the repeal of the new value corollary. As we have noted earlier, this statutory provision provides that a junior interest may not receive any property in a reorganization "on account of" its previous interest before an objecting impaired senior creditor is paid in full. Under this reading of the statute, Bank America contends that, even assuming that LaSalle's reorganization plan meets the requirements of the new value exception, confirmation of the plan violates the statutory language. LaSalle's old equity interest holders, whose claims are junior to those of Bank America, are receiving or retaining property, the ability to continue to run their business, "on account of" their old equity interest.

This interpretation requires, of course, that the phrase "on account of" bear a great deal of weight. As a matter of abstract logic, and certainly of semantics, one can argue that such a meaning can be attributed to these three words. At some level of abstraction, the new investors in the plan can be said to have the opportunity to invest and to control the company "on account of" their previous relationship with the debtor. However, the phrase is also susceptible of another construction. Congress, in using the "on account of" language, might well have intended a more direct causation between the property received by the debtor and the old equity interest. It can be cogently reasoned that, when an old equity holder retains an equity interest in the reorganized debtor by meeting the requirements of the new value corollary, he is not receiving or retaining that interest "on account of" his prior equitable ownership of the debtor. Rather, he is allowed to participate in the reorganized entity "on account of" a new, substantial, necessary and fair infusion of capital.

The mere recitation of the possible interpretations of the statutory absolute priority rule, interpretations argued and reargued in both the cases and the academic literature,[8]

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[8] The district and bankruptcy courts are quite divided over this issue, but a majority of such courts have concluded that the new value corollary survived the passage of the Bankruptcy Code. *See* J. Ronald Trot, Joel G. Samuels & Kevin T. Lantry, "Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification," CA46 ALI-ABA 479, 540-43 (1995) (surveying 88 published district court and bankruptcy court decisions, issued after the Supreme Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), and involving the new value corollary, and stating that, of these, 73% (64 cases) explicitly or implicitly found the new value corollary survived passage of the Bankruptcy Code, 11% (10 cases) determined that it did not, and 16% (14 cases) did not resolve the issue); *see also, e.g., BT/SAP Pool C Assocs. v. Coltex Loop Central Three Partners*, 203 B.R. 527, 534 (S.D.N.Y. 1996) (new value corollary survived codification of absolute priority rule); *In re Way Apartments, D.T.*, 201 B.R. 444, 455 (N.D. Tex. 1996) (same); *In re Sea Garden Motel & Apartments*, 195 B.R. 294, 301 (D.N.J. 1996) (noting that most courts have recognized the continued existence of the new value corollary); *In re Elmwood, Inc.*, 182 B.R. 845, 852-53 (D. Nev. 1995) (applying new value corollary). Academics and commentators, too, have not agreed on the issue. *See, e.g.*, Edward S. Adams, "Toward a New Conceptualization of the Absolute Priority Rule and its New Value Exception," 1993 Det. C.L. Rev. 1445 (concluding that corollary is still viable); Bruce A. Markell, "Owners, Auctions, and Absolute Priority in Bankruptcy Proceedings," 44 Stan. L. Rev. 69 (1991) (same); Jarlon Tsang, Note, 14 Ann. Rev. Banking L. 361 (1995) (same); Clifford S. Harris, Note, 89 Mich. L. Rev. 2301 (1991) (same); Michael H. Strub, "New Value Rule: Applying the Single-Asset Paradigm," 111 Banking L.J. 228 (1994) (concluding pre-Code practice not viable); John D. Ayer, "Rethinking Absolute

(continued...)

evidence the ambiguity of the provision. *See Dewsnup v. Timm*, 502 U.S. 410, 416 (1992) (noting that the contrasting positions of the parties with respect to section 506 and its relationship to other parts of the Code "do embrace some ambiguities"). We therefore must look beyond the statutory language.

The Supreme Court has made it clear that, in interpreting the Bankruptcy Code, we must keep in mind that "[w]hen Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" *Dewsnup*, 502 U.S. at 419 (quoting *In re John M. Russell, Inc. (Emil v. Hanley)*, 318 U.S. 515, 521 (1943)). The Court has been "reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Id.* (citing *United Savs. Ass'n v. Timbers of Inwood Forrest Associates*, 484 U.S. 365 (1988)). As we have noted, for more than fifty years, the new value precept has been recognized as an important corollary or exception to the absolute priority rule. *See In re Snyder*, 967 F.2d 1126, 1128 (7th Cir. 1992). "'[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.'" *In re Snyder*, 967 F.2d at 1129 (quoting *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501

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[8] (...continued)
Priority after *Ahlers*," 87 Mich. L. Rev. 963 (1989) (same); Julie L. Friedberg, Comment, 66 Temp. L. Rev. 893 (1993) (same); Salvatore G. Gangemi & Stephen Bordanaro, Note, "The New Value Exception: Square Peg in a Round Hole," Am. Bankr. Inst. L. Rev. 173 (1993) (same).

(1986)) (brackets in original). In short, the Supreme Court has told us that we are not to abandon past bankruptcy practices absent a clear indication that Congress intended to break from those practices. "We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pennsylvania Dep't Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990).

In this case, there can be no question that "Congress must have enacted the Code with a full understanding" of the absolute priority rule and its new value corollary. *Dewsnup*, 502 U.S. at 419. As this court has detailed on a prior occasion, *see In re Snyder*, 967 F.2d 1126, 1129 (7th Cir. 1992), the new value corollary has long been ensconced in our bankruptcy practice. Indeed, it has been noted in several Supreme Court cases.[9] There was even a proposal before Congress to expand the scope of the new value corollary by eliminating the requirement that the new capital to be provided be in money or money's worth.[10] Yet, despite its awareness of the major role that the new value exception traditionally has played in the bankruptcy field, Congress never explicitly declared, either in the text or in the

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[9] *See, e.g., Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-42 (1946); *Marine Harbor Properties v. Manufacturer's Trust Co.*, 317 U.S. 78, 86 (1942); *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 121 (1939).

[10] *See In re Snyder*, 967 F.2d at 1130 (discussing the Bankruptcy Commission proposal). The proposal was rejected. Because the proposal sought to expand the scope of the new value corollary, Congress' rejection of the proposal hardly supports the view that Congress intended to abolish the entire new value exception. The existence of the proposal assures us of Congress' awareness of the exception.

legislative history of the statute, that it intended the abolition of this important tool.

Of the two textual interpretations, we think that the far more plausible is the one that interprets the "on account of" language to permit the continued existence of the new value corollary. We think that it is more reasonable to believe that Congress legislated on the understanding that, in new value transactions, old equity owners receive stock in exchange for the additional capital they invest. This interpretation is far more reasonable in terms of the practical realities of bankruptcy administration than the highly conceptualistic suggestion that the opportunity to participate in the reorganization is itself property retained on account of an old equity holder's prior ownership interest. As a practical matter, the opportunity to participate in a reorganization plan, even an exclusive right, is not retained on account of an old equity holder's former ownership interest; the opportunity to give new value and to have the opportunity to receive a return on that capital infusion is given because such participation, even exclusive participation, may enhance the value of the business after reorganization. Indeed, exclusivity may be necessary simply because it may be easier to obtain additional funding from the old equity participants.

The new value corollary has been a major source of new funding in reorganizations for the past fifty years. To assume that Congress abolished this device implicitly by the three words "on account of" is to assume that Congress made a major economic decision affecting the economic health, and indeed the continued existence, of many corporate entities without ever addressing squarely the issue in the statute or its legislative history. The Code does provide some flexibility in plan confirmation in the face of dissenting creditors by denying minority dissenting creditors the right to prevent confirmation as long as the requisite majority of the creditors

in each class accepts the plan. To the extent that the new value corollary was, in pre-Code days, a device that gave the plan proponent some leverage in dealing with minority creditors, its necessity may not be as great today as it was in an earlier period.[11] Nevertheless, the new value corollary still serves as a significant source of new funding for the ailing entity,[12] and one would expect that Congress would address deliberately such a significant issue of economic policy if it had determined to abolish it. Notably, Congress gave not one hint, in the text of the statute or its legislative history, that it viewed the new measures regarding the participation of creditors in the approval of the plan to be connected to the continued availability, or the demise, of the new value corollary.

To declare the abolition of the new value corollary would require us to take one of several paths, all of which would be inconsistent with the directions of the Supreme Court of the United States. We could hold that the statutory version of the absolute priority rule is unambiguous in its rejection of the new value corollary and disregard the great body of judicial opinions and serious scholarship that has contended for a

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[11] There are differing views about the effectiveness of the Code's attempt to give the proponents of the plan some flexibility in this regard. The confirmation standard contained in section 1129 still allows slightly more than one third of a class of creditors to veto a plan accepted by every other party to the reorganization and permits a large investor who owns an entire class of securities to thwart any confirmation plan involving shareholder participation.

[12] During times of financial instability, banks often restrict the number of outstanding loans. The resulting "credit crunch" affects the ability of businesses to obtain the capital that they need. During such a period, shareholders might represent the only source of financing for the reorganization of an entity in reorganization.

variety of interpretations. Alternatively, we could acknowledge the provision's ambiguity but disregard the clear direction of the Supreme Court that we are not lightly to infer that Congress has altered by implication established bankruptcy practice. Rather than embark on either of these precarious routes, we shall join the other circuits[13] that have decided the issue and hold that the new value corollary remains a part of our bankruptcy jurisprudence.

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[13] The Ninth Circuit has concluded that the new value exception is alive and well. *In re Bonner Mall Partnership*, 2 F.3d 899, 907 (9th Cir. 1993), *cert. granted*, 510 U.S. 1039, *case dismissed*, 513 U.S. 18 (1994) (case dismissed as moot after parties reached settlement). The Sixth Circuit also has adopted the position that, even after the enactment of the Code, the new value corollary has vitality. *See In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986) ("If McKinlay were retaining an interest without contributing any capital, the plan would clearly violate the Code . . . . But McKinlay is giving up its prior interest and participating in the reorganized company by making a [capital] contribution."). The Fifth Circuit, in *In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992), analyzed the issue quite carefully and concluded that the exception did not survive the Code's enactment. However, after the Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), the court on rehearing rescinded the portion of the opinion deciding the issue instead of evaluating how that decision would affect the case before the court. The Fourth Circuit, in *In re Bryson Properties XVIII*, 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992), struggled with the issue and, after noting that neither the underlying policy reasons nor the legislative history leads to a clear answer, concluded that, in the case before it, the proposed plan, which included a provision by which the old equity holders' new capital contributions would be returned prior to the creditors' unsecured claim, could not be confirmed because the old equity holders retained property on account of their prior interests.

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Bank America further submits that, even if a new value exception were to exist under the Code, the debtor's plan here did not meet its requirements because the amount of capital infused was not substantial. The bankruptcy court found that the plan proposed infusing new capital into the reorganized debtor. The new capital, the court determined, amounted to a present-value money equivalent of $4.1 million. The bankruptcy court also concluded that this capital was necessary for the success of the plan, was in money or money's worth, was reasonably equivalent to the interest retained, and was substantial. Thus, according to the bankruptcy court, the plan met the requirements of the new value corollary and did not violate the absolute priority rule.

We review these findings by the bankruptcy court for clear error. *In re Andreuccetti*, 975 F.2d 413, 419-20 (7th Cir. 1993). "Whether the infusion of new capital is 'substantial' is more a common sense determination than a mathematical calculation when the debtor comprises only a single real estate asset which is fully encumbered." *In re Woodbrook*, 19 F.3d 312, 320 (7th Cir. 1994); *accord In re Snyder*, 967 F.2d 1126, 1131-32 (7th Cir. 1992) ("There is no mathematical formula for resolving the substantiality issue, and it will depend on the circumstances of the individual case."). However, "[c]ontributions that are merely nominal, or gratuitous, token cash infusions" will not suffice to meet this requirement. *Id.* at 1131 (internal quotation and citations omitted). In evaluating whether an infusion is substantial in a particular case, courts are to look at the infusion to determine whether it is real and necessary to the successful implementation of the plan. *See In re Woodbrook*, 19 F.3d at 320.

In this case, under the proposed plan, the investors would infuse $6.125 million into the reorganized debtor to make the reorganization plan work. This capital, the bankruptcy court determined, had a present value of over $4 million. The bankruptcy court, in finding that the amount to be infused was substantial, stated:

> Here, the new value being contributed by the partners is substantial both in absolute terms and in its impact in this case. The $4.1 million minimum value of the contribution in this case dwarfs the $30,000 involved in *Snyder* and the $100,000 in *Woodbrook* . . . . The new value contributions proposed by the September 11 plan are not mere tokens, but genuine contributions to the proposed plan.

In re 203 N. LaSalle St. Ltd. Partnership, 190 B.R. 567, 588 (Bankr. N.D. Ill. 1995). The court also noted that, as a percentage of Bank America's unsecured debt, the contribution amounted to 10.7% of that amount. *Cf. In re Woodbrook*, 19 F.3d at 320 (rejecting invocation of new value corollary when contribution was at most 3.8% of unsecured debt); *In re Snyder*, 967 F.2d at 1131 (rejecting invocation of new value corollary when contribution was 2.7% of unsecured claims). We are not firmly convinced that the bankruptcy court made an error in its determination that this amount, in absolute terms and when viewed as a percentage of Bank America's unsecured claim, was substantial. In addition, the bankruptcy court, in evaluating the feasibility of the plan, found that the infusion of new capital was necessary for the successful implementation of the plan. We have fully discussed this determination and concluded that the bankruptcy court did not clearly err in its finding. We similarly believe that the court's ancillary conclusion that the new infusion was necessary to the success of the plan is adequately supported. We therefore hold that, given our

deferential standards, the court did not clearly err in finding that the new value contributed under the plan is substantial. As such, we shall uphold the bankruptcy court's conclusion that the requirements for the new value corollary have been met.

D. *Impaired Class*

Bank America maintains that the acceptance by the impaired class in this case does not meet the Bankruptcy Code's requirement that, when not all of the impaired classes agree to a proposed plan, at least one impaired class that is not an insider class vote to accept the plan. Bank America submits that the impaired class which approved the reorganization plan, here the trade claims, is an artificially impaired class of claims. Bank America, relying on *In re Windsor on the River Associates*, 7 F.3d 127 (8th Cir. 1993),[14] argues that the reason LaSalle did not pay the trade claims in full under the plan was to create an impaired class that would likely vote in favor of the reorganization claim.[15] Both the bankruptcy and district courts rejected this argument.

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[14] In *In re Windsor*, the Eighth Circuit held that, "for purposes of 11 U.S.C. § 1129(a)(10), a claim is not impaired if the alteration of rights in question arises solely from the debtor's exercise of discretion . . . . Whether Debtor manipulated the terms of its plan for purposes of securing confirmation is a question of fact." 7 F.3d at 132.

[15] Because the plan was confirmed over Bank America's objections, in addition to meeting the other requirements of § 1129, the plan had to meet the "cramdown" requirements as well. "'Cramdown' is the procedure for approving a reorganization plan in the face of creditor resistance. It requires that at least one class of impaired creditors approve the plan . . . ." *In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1313 (7th Cir. 1995).

The bankruptcy court found, and Bank America does not dispute, that the trade claims are impaired. Under the plan, the trade creditors will not receive the interest due to them on their claims. This is definitely an impairment under the Code. *See In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1321 (7th Cir. 1995) (stating that "any alteration of the rights constitutes impairment") (internal quotation and citation omitted). The bankruptcy court further found that the plan was proposed in good faith and that it was necessary, given the total funds that LaSalle had on hand, for the plan to impair some unsecured claims. The court therefore concluded that it did not violate the requirements of the Code for LaSalle to impair the trade claims, even though LaSalle had enough capital that it could have paid these claims in full, so that it would have more money available for reorganization and payment for the bank's claims. The district court concluded that the bankruptcy court's finding that the trade debt class was legitimately impaired was not clearly erroneous.

Although we have never before adopted the Eighth Circuit's "artificial impairment" test, we believe that, even assuming that the Eighth Circuit's interpretation of § 1129(a)(10) is the appropriate standard, the bankruptcy court did not err in its application here. We have noted, in discussing *In re Windsor*, that "[a] finding of 'artificial impairment' requires an inquiry into the purposes of the debtor." *In re Wabash*, 72 F.3d at 1321 n.10. *In re Windsor* recognizes that the question of motivation is one for the bankruptcy court, whose resolution of the question is entitled to deference. 7 F.3d at 132. The bankruptcy court found that there were legitimate reasons for impairing the trade claims class. Impairing these claims allowed more money to be dedicated to the successful reorganization of the debtor. The court distinguished this situation from the one at issue in *In re Windsor* in which the only impairment was to wait 60 days

to pay the "artificially impaired" class in full, and the debtor's only purpose for doing so, according to the Eighth Circuit, was to create an impaired class to approve the plan. In short, the bankruptcy court explicitly found that there was no lack of good faith by LaSalle's failure to pay the trade claims in full. We are not left with the definite and firm conviction that the bankruptcy court has made a mistake with respect to this issue.

E. *Other Issues*

Bank America presses several other claims on appeal, but they need not detain us long. First, Bank America claims that the bankruptcy court clearly erred when it found that the plan subjected its unsecured claim to unfair discrimination. The bankruptcy court agreed with Bank America that the plan discriminated between the unsecured trade claims and Bank America's unsecured deficiency claim. The court, however, disagreed that the discrimination was unfair; indeed, the bankruptcy court found that any discrimination between these claims' treatment under the plan redounds to the benefit of Bank America.

Section 1129(b)(1), which applies to the cramdown confirmation of reorganization plans, provides that a plan may be confirmed only if "the plan does not discriminate unfairly . . . . with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(l). No one contends that the confirmed plan does not discriminate between classes. Under the plan, the unsecured trade creditors would receive 100% of their claims, except for the interest thereon, and Bank America, according to the court, would receive only 16% of its unsecured deficiency under the plan. However, the bankruptcy court found that this discrimination was not unfair because there was a legally acceptable rationale to support

this disparity. Under § 1129(a)(7), the "best interest" test, for a cramdown proposal to be confirmed, each of the creditors in the Chapter 11 reorganization must receive at least as much as they would under a Chapter 7 liquidation. Under such a liquidation, the trade creditors would have been paid in full; whereas, because the unsecured deficiency claim is a statutory creation of Chapter 11, Bank America would not have received anything for the deficiency amount. Consequently, the bankruptcy court reasoned, the disparity between these claims, with the trade creditors receiving 100% and Bank America receiving 16%, is not unfair. Bank America does better than it would have under Chapter 7, and the trade creditors do no worse. Additionally, the plan called for the payment of the bank's unsecured deficiency claim before any insider creditor would be paid. Finally, the bankruptcy court concluded that this discrimination is narrowly tailored to meet the requirements of the "best interest" test. We believe that this explanation adequately explains the difference in treatment between the two classes of unsecured claims, and the bankruptcy court did not clearly err in refusing to find this discrimination unfair.

Second, Bank America contends that, because the primary subjective purpose of the investors in the reorganized debtor is to stave off the tax liability they would incur if the bank were to foreclose, the plan was not proposed in good faith. To be confirmed, a plan must be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). "Though the term 'good faith,' as used in section 1129(a)(3), is not defined in the Bankruptcy Code, . . . the term is generally interpreted to mean that there exists 'a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code.'" *In re Madison Hotel Assocs.*, 749 F.2d 410, 424-25 (7th Cir. 1984) (citations omitted). "According to the good faith requirement of section 1129(a)(3), the court looks to the

debtor's plan and determines, in light of the particular facts and circumstances, whether the plan will fairly achieve a result consistent with the Bankruptcy Code." *Id.* at 425. We begin our inquiry by noting that the bankruptcy court's finding that the plan was proposed in good faith is a finding of fact to which we owe deference. *See In re Andreuccetti*, 975 F.2d 413, 420 (7th Cir. 1992). The primary evidence to the contrary that Bank America provides is that the purpose for the reorganization is a desire by the investors to avoid a significant tax liability.[16] This, in and of itself, is insufficient to establish that the bankruptcy court clearly erred because the desire to avoid significant tax liabilities, if legal, is a result consistent with the Bankruptcy Code. *See In re James Wilson Assocs.*, 965 F.2d 160, 170 (7th Cir. 1992) ("It is not bad faith to seek to gain an advantage from declaring bankruptcy—why else would one declare it?"). Bank America also posits that the plan was not proposed in good faith because the risk of the plan falls squarely on Bank America. The bankruptcy court, however, found otherwise. Much of the risk of the plan falls on the shoulders of the new investors. Moreover, Bank America, by focusing on the tax consequences to the plan's investors, appears to be urging that we look at the subjective motivations of those proposing the plan. *In re Madison*'s teachings are to the contrary. The bankruptcy court cataloged the objective benefits and likely

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[16] Bank America also asserts that the only purpose of the reorganization plan is to "stave off the evil day when the creditors take control of [the debtor's] property." *In re James Wilson Assocs.*, 965 F.2d 160, 170 (7th Cir. 1992). According to Bank America, under *In re James Wilson*, such a plan is a clear case of bad faith. However, unlike the situation contemplated in *In re James Wilson*, LaSalle did not "enter[ ] Chapter 11 knowing that there [was] no chance to reorganize [its] business." *Id.* Rather, two courts have already ruled that LaSalle is able to reorganize its business.

results of the plan, and these are not inconsistent with the Code. We therefore hold that the bankruptcy court did not clearly err when it determined that the plan it confirmed was proposed in good faith.

Finally, Bank America asks that, if we reverse the district and bankruptcy courts' holdings on any issue, we also reverse the bankruptcy court's orders denying (1) relief from the automatic stay and (2) Bank America's request to convert or dismiss the case. Because we uphold the district court's judgment in its entirety, we deny Bank America's request.

Conclusion

For the foregoing reasons, we affirm the judgment of the district court.

AFFIRMED

KANNE, *Circuit Judge*, dissenting. Although I agree with the way the majority opinion handles many of the issues in this case, I must dissent because the plain language of the absolute priority rule, *see* 11 U.S.C. § 1129(b)(2)(B)(ii), does not include a new value exception. Moreover, even if one strains and finds ambiguity in the language of the statute, thus necessitating a look at pre-Code practice, *see Dewsnup v. Timm*, 502 U.S. 410 (1992), the shaky foundation of the pre-Code new value exception coupled with the massive changes in bankruptcy procedures brought on by the Bankruptcy Code demonstrate that Congress did not intend to insert a new value exception into § 1129(b)(2)(B)(ii).

I. PLAIN LANGUAGE

A reorganization plan must be "fair and equitable" to be implemented over the objection of an impaired class of creditors. The absolute priority rule helps define what is "fair and equitable" under a reorganization plan. *See* 11 U.S.C. § 1129(b)(2). A "fair and equitable" plan meets one of two requirements: (1) a class of unsecured creditors must receive property equal to the value of its claim on the effective date of the plan, *see* § 1129(b)(2)(B)(i), or (2) a dissenting class of unsecured creditors must be fully provided for before any junior class can receive or retain property under the plan, *see* § 1129(b)(2)(B)(ii) ("the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property"). In this case, the reorganization plan (the "Plan") does not satisfy the first prong because Bank America will not receive property equal to the value of its $38.5 million deficiency claim on the effective date of the Plan. The Plan also does not satisfy the second requirement—the absolute priority rule—because it permits LaSalle's partners, whose interests are junior to those of Bank America, to "receive or retain" property—*i.e.*, the

exclusive right to retain their equity interests[1] — "on account of" their junior equity interests.

The majority maintains that LaSalle's partners do not retain a property interest "on account of" their prior equity interest, but rather "'on account of' a new, substantial, necessary and fair infusion of capital." *Ante*, at 17. The majority nonetheless admits, as it must, that "the new investors in the plan can be said to have the opportunity to invest and to control the company 'on account of' their previous relationship with the debtor." *Ante*, at 16; *see also In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1993) ("[I]n some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners."), *motion to vacate denied and cert. dismissed as moot*, 513 U.S. 18 (1994). Despite this concession, the majority asserts that only "[a]s a matter of abstract logic, and . . . of semantics," one can argue that LaSalle's partners retained property "on account of" their prior interests, and it further surmises that Congress "might

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[1] A debtor's *exclusive right* to receive or retain an equity interest is property for purposes of the new value exception and the absolute priority rule. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-08 (1988) ("Even where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains 'property.'"); *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir. 1992) ("This exclusive right to contribute constitutes 'property' under § 1129(b)(2)(B)(ii), which was received or retained on account of a prior interest."); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1360 (7th Cir. 1990) ("An option to purchase stock also is 'property.'"); *see also Ahlers*, 485 U.S. at 208 ("[W]hile the Code itself does not define what 'property' means as the term is used in § 1129(b), the relevant legislative history suggests that Congress' meaning was quite broad.").

well have intended a more direct causation between the property received by the debtor and the old equity interest." *Ante*, at 16-17; *see also Bonner Mall*, 2 F.3d at 909 (noting that "[c]ausation for any event has many and varied levels" and asserting that Congress surely intended a more "direct or immediate causation"). The majority instead believes that the statute implicitly incorporates a "new value corollary" that permits prior interest holders to retain their interests by infusing new capital into the indebted property. The plain language of § 1129(b)(2)(B)(ii), however, fails to even hint at such a corollary or exception. Indeed, this position not only belittles the straightforward language of § 1129(b)(2)(B)(ii) but also ignores the application of that language to the facts of this case.

The Plan permits LaSalle's partners to retain their equity interests "on account of" two separate factors. LaSalle and the majority opinion correctly assert that LaSalle's partners retain their ownership interests "on account of" their new capital contributions. One cannot contest the fact that the partners' new capital contributions are one reason why they are able to maintain their ownership of the indebted property. LaSalle's partners, however, receive this *exclusive* ownership right *only* "on account of" their unique status as prior equity holders. The Plan's grant of this *exclusive* right to LaSalle's partners thus provides a *necessary* element that causes the prior equity holders to retain their junior interests before the satisfaction of Bank America's deficiency claim. "Abstract logic" and "semantics" do not suggest this conclusion—the requirements of the Plan and the language of the statute mandate it.

The motivations of LaSalle's partners magnify this point. They put new capital into the indebted property only so they could postpone the tax losses that they would incur in a foreclosure. In other words, regardless of the new capital

contributions provided by LaSalle's partners, the presence of (and the potential tax liability inherent in) the partners' prior equity interests motivated the Plan's inclusion of the partners' exclusive right to retain their equity interests. The most natural and literal reading of this statute, when applied to the facts of this case, leads one to the inescapable conclusion that LaSalle's partners are retaining their equity interests "on account of" their junior interests in the property.

The Fourth Circuit, in *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1992), adopted this very reasoning in rejecting a debtor's request for application of the new value exception. *Id.* at 504. *Bryson* refused to approve a reorganization plan that gave prior equity holders the *exclusive right* to "'buy' the [indebted] property without exposing it to the market or otherwise allowing any other party . . . the opportunity to bid." *Id.* Although the Fourth Circuit did not explicitly hold in so many words that § 1129 does not include a new value exception or corollary, the outcome of the case reveals a strong devotion to the straightforward language of § 1129(b)(2)(B)(ii) and an implicit rejection of the new value exception.[2]

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[2] Contrary to the majority's suggestion that the courts of appeals that have addressed this issue have all ruled that the new value exception did survive the enactment of the Bankruptcy Code, *see ante*, at 22 & n.13, *Bryson*'s outcome and analysis reveal that the circuits are not in agreement on the issue. The Ninth Circuit has conducted perhaps the most exhaustive discussion of the issue to date, and it determined that the new value exception remains viable. *See Bonner Mall*, 2 F.3d at 899. The Sixth Circuit also recognized, without discussion, the existence of the new value exception. *See In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986). A Fifth Circuit panel, however, originally concluded that the new value exception did not survive the enactment of the Code, see

(continued...)

The majority's reading of the statute effectively inserts the words "solely or primarily" before "on account of": "*the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan* ***SOLELY or PRIMARILY*** *on account of such junior claim or interest any property.*" The majority, in other words, qualifies the text of § 1129, and thus permits a departure from an otherwise firm rule that a bankruptcy entity's assets should be assigned by absolute priority. Perhaps the majority's reasoning is driven by the fear that a "but for" interpretation would prevent old equity from ever participating in a reorganized entity—something Congress could never have intended. Indeed, such a result would border on the absurd, but a simpler, "but for" causation requirement would not preclude junior interests from participating in a reorganized entity. If prior equity holders earn their shares in an open auction, for example, their received interests would not be "on account of" their junior interests but "on account of" their capital contributions. *See In re Greystone III Joint Venture*, 995 F.2d 1274, 1283 (5th Cir. 1991), *withdrawn on rehearing* (1992) (Judge Jones dissented from the withdrawal of Part IV, which discusses the new value exception); *Bryson*, 961 F.2d at 504; *In re Outlook/Century Ltd.*, 127 B.R. 650, 654 n.4 (Bankr. N.D. Cal. 1991).

Moreover, the majority opinion fails to consider how its interpretation of the words of "on account of" in

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[2] (...continued)
In re Greystone III Joint Venture, 995 F.2d 1274, 1281-84 (5th Cir. 1991), *withdrawn on rehearing* (1992); two members of that panel later voted to withdraw the part of the opinion that dealt with the new value exception, apparently in response to *Dewsnup*. *Id.* at 1284-85 (Judge Jones dissented from the removal of the new value exception analysis.).

§ 1129(b)(2)(B)(ii) compares to the use of those same words in other parts of the same section. Section 1129(b)(2)(B)(i), for example, provides that a plan is fair and equitable with respect to a class of unsecured claims if "the plan provides that each holder of a claim of such class receive or retain *on account of* such claim property of a value . . . equal to the allowed amount of such claim." 11 U.S.C. § 1129(b)(2)(B)(i) (emphasis added). In this subsection, "on account of such claim" takes a simple, ordinary "but for" or "because of" meaning. In other words, § 1129(b)(2)(B)(i) provides that a plan is fair and equitable with regard to an impaired, unsecured claim if the holder of an unsecured claim receives a value equal to *that particular unsecured claim*. It would unduly complicate the statute, and indeed make no sense, to insert "primarily or solely" before "on account of such claim" in subsection § 1129(b)(2)(B)(i). Congress surely could not have intended such a meaning for that subsection. Nonetheless, the majority seems to think that Congress intended such a meaning for the very same words in the very next subsection. Such a reading of § 1129(b)(2)(B)(ii) ignores the well-established cannon of statutory interpretation that "identical words used in different parts of the same act are intended to have the same meaning." *Sullivan v. Stroop*, 496 U.S. 478, 484 (1990) (quoting several prior Supreme Court cases); *see also United States v. Nippon Paper Indus. Co.*, 109 F.3d 1, 4-5 (1st Cir. 1997) ("It is a fundamental interpretive principle that identical words or terms used in different parts of the same act are intended to have the same meaning . . . . This principle—which the Court recently called 'the basic cannon of statutory construction'—operates not only when particular phrases appear in different sections of the same act, but also when they appear in different paragraphs or sentences of a single section.") (citations omitted), *petition for cert. filed*, 65 U.S.L.W. 3839 (U.S. June 13, 1997) (No. 96-1987).

Furthermore, I cannot subscribe to the notion that the language of § 1129(b)(2)(B)(ii) must be deemed ambiguous merely because the case law and the academic literature have interpreted it in different ways. The majority relies upon *Dewsnup* in stating that the "mere recitation of the possible interpretations" of the absolute priority rule renders § 1129's language ambiguous. *Ante*, at 17. But *Dewsnup* and other Supreme Court precedent also command courts to apply a statute's unambiguous language without looking beyond it. *See Dewsnup*, 502 U.S. at 419-20 ("Of course, where the language is unambiguous, silence in the legislative history cannot be controlling."); *Union Bank v. Wolas*, 502 U.S. 151, 155-56 (1991) ("Given the clarity of the statutory text, respondent's burden of persuading us that Congress intended to create or to preserve a special rule . . . is exceptionally heavy."); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-41 (1989) ("[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute."). As Justice Scalia noted in his dissent in *Dewsnup*, the Supreme Court has "*never* held pre-Code practice to be determinative in the face of . . . contradictory statutory text." *Dewsnup*, 502 U.S. at 433 (Scalia, J., dissenting).

A natural reading of § 1129(B)(2)(b)(ii) prohibits a junior interest holder from retaining property in the debtor "on account of" or "because of" its status as a prior interest holder. The Plan in this case gives LaSalle's partners the exclusive right to retain their ownership interest in the indebted property *because of* their status as a prior interest holder. Because the straightforward text of the statutory absolute priority rule prohibits such a Plan where there are dissenting, unsecured creditors, I see no need to look beyond the words of the statute.

II. Pre-Code Practice

Assuming, *arguendo*, that the language of § 1129(b)(2)(B)(ii) is ambiguous, a review of the pre-Code bankruptcy practice does not dictate the adoption of the new value exception. In *Dewsnup*, the Supreme Court noted that Congress did "not write 'on a clean slate'" when amending the bankruptcy laws and that the "Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup*, 502 U.S. at 419. Because nearly everyone agrees that the legislative history "sheds little light" on the vitality of the new value exception, *see Bryson*, 961 F.2d at 504 n.13,[3] the majority uses *Dewsnup* to argue that we must interpret the Code to include the new value exception.

While pre-Code practices have long helped courts interpret ambiguous Bankruptcy Code provisions, they cannot require courts to read unestablished, disputed, or outdated pre-Code principles into the Code. *Dewsnup* understated its

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[3] In this circuit, we have speculated inconclusively on the meaning of the sparse legislative history. Some cases have suggested that Congress's rejection of a proposal by the Bankruptcy Commission to modify the absolute priority rule and its exceptions reveals that Congress did not intend to include such an exception when enacting the Code. *See, e.g., Kham & Nate's*, 908 F.2d at 1261-62 (noting that Congress was aware of the rule and its exceptions when it adopted the "blanket" absolute priority rule without "suggest[ing] a single exception"). Other cases have pointed out, however, that the proposed (but rejected) rule sought to *ease* the requirements of the new value exception, and thus the "rejection of the modification could just as easily be construed as an endorsement of the status quo." *In re Snyder*, 967 F.2d 1126, 1130 (7th Cir. 1992).

point that Congress does not write on a clean slate when amending the bankruptcy laws because "Congress in fact writes bankruptcy laws on a very messy slate." *In re A.V.B.I., Inc.*, 143 B.R. 738, 746 (Bankr. C.D. Cal. 1992). For that reason, "[i]mporting concepts from past reorganization cases into interpretation of the Code must be done gingerly, with proper attention to the context in which the original case arose." *Id.*

In *Dewsnup*, for example, once the Court found the language of 11 U.S.C. § 506 to be ambiguous, its look at the pre-Code practice regarding the involuntary reduction of a creditor's lien arguably proved to be a fruitful venture. *See Dewsnup*, 502 U.S. at 419. *But see A.V.B.I.*, 143 B.R. at 744-47 (questioning *Dewsnup*'s conclusion regarding the established nature of the relevant pre-Code practice). The *Dewsnup* Court noted that its own cases had not permitted involuntary reductions and that, indeed, such reductions might face constitutional scrutiny under the Takings Clause. *See Dewsnup*, 502 U.S. at 419. *Dewsnup* also found legislative history suggesting that Congress intended for § 506(d) to permit liens to pass through bankruptcy unaffected. *See id.* The Court therefore reasoned that because the bankruptcy laws had never permitted such a reduction of a creditor's lien, Congress could not have intended to "grant a debtor [a] broad new remedy" without mentioning that remedy in the Code or the legislative history.[4] *Id.* at 420.

In the situation of the absolute priority rule, however, a critical look at the pre-Code practice does not reveal Congress's intent to include a new value exception in

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[4] Justice Scalia's dissent in *Dewsnup* contends, however, that the language of § 506(a) & (d) unambiguously granted such a remedy. *See Dewsnup*, 502 U.S. at 420.

§ 1129(b)(2)(B)(ii). Rather, the Bankruptcy Code so fundamentally altered the pre-Code reorganization and confirmation procedures that strict adherence to the pre-Code new value exception might *contravene* Congress's intent in codifying the absolute priority rule.

The reasonableness of reading the pre-Code new value exception into the codified absolute priority rule is initially harmed by the questionable foundation upon which that exception rests. The Supreme Court's "creation" of the new value exception in *Case v. Los Angeles Lumber Prods., Co.*, 308 U.S. 106, 121-22 (1939), was merely *dicta* because the Court ultimately ruled that nonmonetary value cannot sufficiently satisfy any type of new value exception. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203-04 (1988); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361 (7th Cir. 1990). In addition, *Case* never remarked on whether creditors must consent to a plan that permits old equity holders to input new capital in order to retain ownership of the debtor even though the Supreme Court case upon which *Case's dicta* relied—*Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445 (1926)—presented such a situation. *See Kham & Nate's*, 908 F.2d at 1361. Furthermore, the Supreme Court has never upheld the confirmation of a new value plan over a creditor's objection, *see A.V.B.I.*, 143 B.R. at 743, the Court has expressly stated that the vitality of the new value exception is an open issue, *see Ahlers*, 485 U.S. at 203 n.3, and the district and bankruptcy courts are divided on the issue, *see* J. Ronald Trost, et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, CA46 ALI-ABA 479, 540-43 (1995). "[L]ike other Supreme Court dicta," it seems that the "'new value' exception has taken on a life of its own in the lower courts." *A.V.B.I.*, 143 B.R. at 743 (citing John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963, 1016

(1989)); *see also Kham & Nate's*, 908 F.2d at 1360 ("So far as the Supreme Court is concerned, however, the development [of the new value exception] has been 100% dicta."). And unlike *Dewsnup*, there is no express legislative history suggesting that Congress intended the exception to survive.

Moreover, the bankruptcy law principles underlying the "creation" and "development" of the new value exception differ greatly from those under the present Bankruptcy Code. Prior to the enactment of the Code in 1978, bankruptcy law consisted of a number of provisions differing from each other regarding the confirmation of reorganization plans and the existence of "fair and equitable" standards in those situations. In *Case*, for example, Section 77B of the Bankruptcy Act of 1898 required that creditors unanimously consent to a debtor's reorganization plan and that the plan meet a "fair and equitable" standard developed under the common law. *See Case*, 308 U.S. at 114-15; *Kham & Nate's*, 908 F.2d at 1360-61. Section 77B, which lasted only 4 years, quickly gave way to Chapters X and XI of the Bankruptcy Act. 7 Collier on Bankruptcy, ¶ 1129.04[4][c], at 1129-105 (Lawrence P. King ed., 15th rev. ed. 1997). Chapter X retained Section 77B's "fair and equitable" requirement, and it mandated the appointment of a disinterested trustee to control the reorganization of the debtor. *Id.* ¶ 1129.04[4][c], at 1129-106.[5] Chapter XI included a "fair and equitable" rule

[5] Under Chapter X, no shareholder ever convinced a court that it contributed sufficient value to retain an interest under the new value concept, and no reported case expressly adopted *Case*'s new value *dicta* as its holding until the Code's enactment in 1978. 7 Collier on Bankruptcy, ¶ 1129.04[4][c], at 1129-107.

when enacted in 1938, but that concept was repealed from Chapter XI in 1952. Id. ¶ 1129.04[4][b], at 1129-92 n.105.[6]

The enactment of the Bankruptcy Code in 1978, however, fundamentally changed this bankruptcy backdrop. Chapter 11 of the Code "reflects a melding of concepts derived from several [of these and other] distinct bodies of pre-Code law" combined with the "conscious purpose . . . to create a new chapter that represented the best of all these approaches to reorganization." *A.V.B.I.*, 143 B.R. at 746-47. Significantly, the Code eliminated the unanimous consent requirement among creditors, *see* 11 U.S.C. § 1126(c), and it required a "fair and equitable" test whenever an impaired class of creditors rejects a reorganization plan, *see* 11 U.S.C. § 1129(b)(l). The Code, moreover, provided the first codification of this "fair and equitable" test. *See* 11 U.S.C. § 1129(b)(2). The present, increased flexibility in confirming reorganization plans coupled with new codifications thus represents a significant change from pre-Code bankruptcy law and arguably renders the new value exception unnecessary. *See Greystone III*, 995 F.2d at 1282, 1285 (Jones, J., dissenting).

Current bankruptcy practice also differs from pre-Code practice because most Chapter 11 cases are now operated by debtors-in-possession rather than court-appointed trustees.

[6] Because the absolute priority rule no longer applied to Chapter XI proceedings after 1952, cases under that chapter did not address any new value issues. 7 Collier on Bankruptcy, ¶ 1129.04[4][c], at 1129-106 to 1129-107; *see also id.* ¶ 1129.04[4][a], at 1129-84 to 1129-85. The number of parties that could potentially seek application of new value principles further declined due to a preference for filing under Chapter XI rather than Chapter X, which is partially explained by Chapter X's disinterested trustee requirement. *Id.* ¶ 1129.04[4][c], at 1129-106.

See A.V.B.I., 143 B.R. at 743. When the Court decided *Case*, a new value exception to the absolute priority rule may not have been objectionable to creditors because the court-appointed trustee would presumably sell the property back to the equity holders only after it "examined the books and operations" and had not "unearthed any dishonesty or mismanagement." *Id.* The present Chapter 11 framework, however, "permits uninterrupted control by insiders," and therefore creates situations where creditors fear that the reorganizations "are run for the private benefit of existing salaried management and the equity holders, with the intent of unfairly squeezing out the creditors." *Id.*

The enactment of the Code further altered prior bankruptcy practice by removing bankruptcy judges' "equitable powers to modify contracts to achieve 'fair' distributions." *Kham & Nate's*, 908 F.2d at 1361. "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Ahlers*, 485 U.S. at 206. The notion that the Code, rather than equitable principles, permits a non-consensual plan to "sell" the indebted property to its old owners flies in the face of Chapter 11 and *Ahlers*: "The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code." *Ahlers*, 485 U.S. at 207; *see also id.* (providing that "it is up to the creditors—and not the courts—to accept or reject a reorganization plan which . . . . fails to honor the absolute priority rule"). "In effect, Section 1129(b)(2)(B) of the Code gives the creditors—not the court—the right to decide whether to waive the absolute priority rule." *A.V.B.I.*, 143 B.R. at 744.

In light of the elimination of the unanimous consent requirement, the current trend of operation by debtors-in-possession, and the decrease of bankruptcy courts' equitable powers, retaining the "new value exception" arguably gives debtors a "broad new remedy"—exactly the sort of balance-upsetting interpretation that *Dewsnup* rejected. The present case is therefore more like *Wolas* than *Dewsnup*.

The debtor in *Wolas* maintained that 11 U.S.C. § 547(c)(2), which makes an exception to the rule authorizing a trustee to avoid certain property transfers made by a debtor within ninety days before bankruptcy, did not apply to payments on long-term debt. Although the text of § 547(c)(2) did not distinguish between long-term debt and short-term debt, the debtor argued, among other things, that Congress intended to codify the pre-Code "current expense" rule, which would ultimately limit § 547(c)(2)'s exception to short-term debt. *Wolas*, 502 U.S. at 158-59. The Court rejected this argument, reasoning that there was no extrinsic evidence or legislative history suggesting that Congress intended to codify the current expense rule. *Id.* at 159 & n.14. Significantly, the Court also noted that the Code substantially enlarged the trustee's power to avoid preferential transfers, and that it could not "assume that the justification for narrowly confining the 'current expense' exception" to certain situations before the enactment of the Code should apply to an exception in the Code. *Id.* at 159-60. Rather, "the fact that Congress carefully reexamined and entirely rewrote the preference provision in 1978 supports the conclusion that the text of § 547(c)(2) as enacted reflects the deliberate choice of Congress." *Id.* at 160; *see also id.* at 160 n.15 (citing the legislative history and noting that Congress intended to undo the "hopelessly complex" pre-Code preference section by proposing a "unified and coherent section to deal with the problems created by prebankruptcy preferential transfers"). In our case, as in *Wolas*, Congress significantly changed the

underlying law upon which the pre-Code absolute priority rule and new value exception relied by creating a new Chapter 11 to deal with reorganization procedures and requirements.

Keeping in mind the significant differences in the pre-Code bankruptcy environment, strict adherence to a tenuous pre-Code practice makes little sense. Even if *Dewsnup* repudiated prior bankruptcy statutory interpretation cases like *Wolas* and *Ron Pair* and effectively mandated a review of pre-Code practice in any case where the parties disagree on the meaning of the statute's language, *see Dewsnup*, 502 U.S. at 435 (Scalia, J., dissenting) ("I have the greatest sympathy for the Courts of Appeals who must predict which manner of statutory construction we shall use for the next Bankruptcy Code case."), the pre-Code rationale for the new value exception makes little sense in today's Chapter 11 environment. The majority, due to its uncritical adherence to *Dewsnup*, creates an anachronism by cutting and pasting pre-Code practice into a fundamentally different bankruptcy context. As a result, we are left with a new § 1129(b)(2)(B)(ii) that Congress likely never intended. For that reason, I must dissent from the majority's otherwise solid opinion.[7]

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[7] In furthering its reasoning, the majority lists the significant advantages gained by the existence of a new value exception to the statutory absolute priority rule. *Ante*, at 20-21; *see also Bonner Mall*, 2 F.3d at 915-16; *Snyder*, 967 F.2d at 1130. Much ink has already been spilled debating the benefits and detriments of the new value exception in the context of Chapter 11, and my opinion will likely add little to the debate. I do, however, feel that the majority's policy arguments should not go unanswered.

Without question, the ability to infuse new capital from old equity holders provides a valuable tool for reorganizations. The

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Clerk of the United States Court of Appeals for the Seventh Circuit

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[7] (...continued)
creditors, however, should be able to make the ultimate decision regarding whether to incorporate such new value. *See Greystone III*, 995 F.2d at 1284, 1285 (Jones, J., dissenting) ("It is dubious to suppose that courts will ordinarily possess superior foresight than the creditors themselves concerning the creditors' best interests."). Rejection of the new value exception, moreover, will not extinguish "new value" as a beneficial tool for reorganization. *See Bryson*, 961 F.2d at 504 (noting that if a "plan represents a reasonable business risk, creditors should be willing to forego immediate recoveries in exchange for the expectation of greater recoveries in the future, in which case they would consent to viable plans providing for new capital infusions"). Creditors regularly consent to new value plans, *see A.V.B.I.*, 143 B.R. at 743, and they will continue to do so even when they are not faced with the threat of a cramdown, *see Kham & Nate's*, 908 F.2d at 1360 (noting that creditors effectively own bankrupt firms and that in many instances the creditors should be willing to consent to a voluntary plan that allows old equity holders to gain stock in return for inputting new value). Finally, providing this power to creditors alone, and removing it from the courts, will provide the incidental benefit of removing an "enormously complicating factor" from the "carefully balanced bargaining structure" used to formulate consensual reorganization plans. *Greystone III*, 995 F.2d at 1283-84, 1285 (Jones, J., dissenting); *cf. Bonner Mall*, 2 F.3d at 917 (discussing the need for bankruptcy courts to "carefully apply" the strictures of the new value exception in order to prevent old equity from circumventing the purpose of the absolute priority rule).

APPENDIX B

United States Court of Appeals

for the Seventh Circuit
Chicago, Illinois
November 25, 1997.

Before

Hon. WALTER J. CUMMINGS, Circuit Judge

Hon. KENNETH F. RIPPLE, Circuit Judge

Hon. MICHAEL S. KANNE, Circuit Judge

IN THE MATTER OF:	) Appeal from the United
	) States District Court for
203 N. LASALLE STREET	) the Northern District of
PARTNERSHIP, an Illinois	) Illinois, Eastern
Limited Partnership,	) Division.
	)
Debtor-Appellee,	)
	) No. 95 C 7144 and
	) 96 C 238.
Nos. 96-2137 & 96-2138	) Paul E. Plunkett,
	) Judge.
	)
APPEAL OF: BANK OF	)
AMERICA ILLINOIS,	)
	)
Appellant.	)

ORDER

On consideration of the petition for rehearing and suggestion for rehearing en banc filed by the appellant, Bank of America Illinois, on October 10, 1997, and amended on October 22, 1997, a majority of the panel voted to deny the petition for rehearing. A vote of the active members of the court was requested on the suggestion for rehearing en banc. The voting active judges* of the court have voted to deny hearing en banc.** Accordingly,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing en banc be, and the same is hereby DENIED.

*Circuit Judge Joel M. Flaum did not participate in the consideration of the petition for rehearing en banc.

** Circuit Judges Coffey, Easterbrook, Manion, Kanne, and Diane P. Wood voted to grant rehearing en banc.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

BANK OF AMERICA, ILLINOIS,	)	**Consolidated Cases**
	)	**Nos. 95 C 7144 & 96 C 0238**
Appellant,	)	
	)	
v.	)	**Appeal From**
	)	**No. 95 B 4998**
203 NORTH LASALLE STREET	)	**Chapter 11**
PARTNERSHIP, an Illinois	)	
limited partnership,	)	
	)	**Hon. Paul E. Plunkett**
Appellee.	)	

[April 30, 1996]

MEMORANDUM OPINION AND ORDER

The Appellant Bank of America, Illinois (the "Bank") appeals from three orders entered by the United States Bankruptcy Court for the Northern District of Illinois (Honorable Eugene Wedoff) in the underlying Chapter 11 case of 203 North LaSalle Street Partnership (the "Debtor"): an order (the "Confirmation Order") confirming over the objection of the Bank, the Debtor's major creditor, the Debtor's Second Amended Plan of Reorganization Dated September 11, 1995 as modified (the "Plan"), *In re 203 North LaSalle Street Limited Partnership*, 190 B.R. 567 (Bankr. N.D. Ill. 1995); and two orders denying the Bank's motion for relief from the automatic stay and the Bank's motion to convert the Debtor's Chapter 11 case to one under

Chapter 7 of the Bankruptcy Code (the "Code").[1] The Debtor also moves to dismiss the Bank's appeal as moot. For the reasons set forth below, we deny the Debtor's motion to dismiss the appeal and affirm the orders of the bankruptcy court in all aspects.

Background

We summarize the bankruptcy court's findings of fact, set forth in it Memorandum of Decision ("Bk. Dec.") as follows.

The Debtor is an Illinois limited partnership that owns the upper fifteen floors of office space (the "Property") in a building in the central business district of Chicago. The lower floors are separately owned. The Property is encumbered by a lien in favor of the Bank that secures a nonrecourse note in the principal amount of $92,582,000. The note became due and payable, according to its terms, on January 3, 1995. The debtor was unable to pay the note at that time, and the Bank commenced a state court foreclosure action on January 20, 1995. In response, the debtor filed this bankruptcy case on March 13, 1995. At that time, the Bank's claim, principal and interest, was $93,013,612. Several smaller claims were outstanding at the time of filing: (a) a state property tax claim of about $2.3 million; (b) general unsecured trade debt of about $160,000; (c) unsecured insider claims of $7.7 million (of which $6.8 million is a claim of the Debtor's general partner for an unsecured loan); and (d) a second mortgage held by the Debtor's general partner in the amount of $11.3 million. After the filing, the Debtor's general partner purchased some of the trade claims, reducing

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[1] Unless otherwise specifically noted, all section references are to the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*

the general unsecured claims held by non-insiders to about $90,000. In addition to its real property, the Debtor holds the right to a cash account, consisting of prepetition rents, that at the time of confirmation held approximately $3.1 million.

The Debtor proposed its original plan of reorganization on April 13, which was subsequently amended on May 12. After briefing and a hearing, the bankruptcy court denied confirmation of the plan on August 7. The principal ground for the ruling was unfeasibility: the minimum interest rate that the court found to be required for payment of the Bank's secured claim could not be supported by the projected cash flow of the Property. However, because the question of the appropriate interest rate was an unsettled legal issue, the court allowed the Debtor an opportunity to amend its plan. After several revisions, the debtor proposed the plan dated September 11. The court again held a hearing and ultimately confirmed the Plan in an order dated December 6, 1995.

The principal factual dispute between the parties concerned the value of the Property and the cash flow it was likely to generate. Both the Debtor and the Bank presented expert appraisal testimony on these issues, and the experts agreed that the most appropriate valuation method was discounted cash flow. This technique operates in three steps. First, the appraiser estimates the cash flow that the property will generate each year of a several year holding period. Next, the appraiser determines the "reversionary" value of the property at the end of the period by capitalizing a stabilized income that is estimated to produce at that time. Finally, using an appropriate discount rate, the appraiser reduces the values derived in the first two steps to present values and combines them to arrive at the value of the property. The bankruptcy court accepted the discounted cash flow method. Thus, to arrive at a value of the property, it

was necessary to: (1) estimate net cash flows over an appropriate holding period; (2) determine an appropriate capitalization rate for the reversion; and (3) determine an appropriate discount rate.

Each of the appraisers chose a period of ten years for estimating annual cash flow, then capitalized a stabilized income for the eleventh year. The appraisers differed, however, in their estimates of income and in the capitalization and discount rates they applied. The Debtor's appraiser applied a higher discount rate (14.367%) to overall higher income estimates; the Bank's appraiser used both a lower discount rate (11.75%) and lower income estimates. The Debtor's estimated cash flow for the ten years was $58.285 million leading to a present value of $28.628 million. The Bank's estimated cash flow was $48.077 million leading to a present value of $27.457 million—about $1.1 million lower than the Debtor's.

The appraisers also differed in their calculation of reversionary value, but the Debtor's valuation was about $4.8 million less than the Bank's. In sum, the Debtor arrived at an estimated value of $53.75 million, while the Bank arrived at an estimated value of $57.4 million.

The bankruptcy court did not accept either of these valuations. The future cash flows depend primarily on the renewal of leases. The Property is currently nearly fully leased, but two leases to major tenants will expire during the ten year period. The debtor negotiated a renewal of one of these leases, to Rudnick & Wolfe, contingent on confirmation of the Plan, and that renewal is reflected in the appraisers' estimates of cash flow. However, the other major tenant, Coopers & Lybrand, has not agreed to renew its lease. The Bank's appraiser treated this tenant's lease in the same way as other smaller tenants, estimating a 50% chance of renewal.

The Debtor's appraiser, on the other hand, assumed a one hundred percent chance of renewal and assumed highly favorable circumstances in that renewal. The bankruptcy court's assessment of the situation lay generally between those of the appraisers. It found that the size of the space occupied by the tenant and the paucity of available alternative space made it very likely that the tenant would renew, but that the importance of that tenant to the Debtor's operations would likely allow it concessions that would depress the debtor's cash flow under the renewed lease. Thus the court's estimate reflected no extraordinary loss at the time of the lease expiration, but lower income thereafter than suggested by either appraiser.

The bankruptcy court also found that the difference in capitalization and discount rates of the appraisers reflected their different approaches to income estimation. The Debtor's appraiser set both rates at the high end of the spectrum of reasonable rates to reflect its view that the cash flow projections were somewhat risky, whereas the Bank's appraiser used lower rates to reflect its belief in the high quality of the building and perhaps the conservative estimate of cash flow. The court's view was that if income is properly estimated based on likely leasing results, the rates employed should be those of an average building of the Debtor's type—in this case, a first-class office building in the central business district. From data presented by the appraisers, the court took these rates to be a 10% terminal capitalization rate and a 12% discount rate.

Applying the 12% discount rate to future cash flows as found by the court, the court found a present value over the ten-year period of $30.0 million, as follows:

Year Ending	Estimated Cash Flow (in $ thousands)	Present Value (discounted at 12%)
1996	4,100	3,661
1997	5,700	4,545
1998	5,300	3,772
1999	5,700	3,621
2000	6,900	3,916
2001	7,300	3,698
2002	1,000	452
2003	3,800	1,538
2004	6,500	2,344
2005	7,700	2,479
Total	54,000	30,026

The court then calculated the present value of the reversion, based on stabilized income in the eleventh year of $8.2 million, capitalized at 10%, as $25.8 million, as follows:

Estimated Stabilized Income (in $ thousands)	8,200
Capitalization Rate	.10
Gross Reversionary Value	82,000
Estimated Disposition Cost	1,845 (2.25%)
Net Reversionary Value	80,155
Discount Rate	.12
Present Value	25,806

The bankruptcy court thus calculated the value of the Property, at the time of the confirmation hearing, as $55.8 million.

The claims and interests in the Plan are divided into the following classes, of which classes 1 and 2 are unimpaired, and classes 3-7 are impaired:

Class 1: Priority Claims.

Class 2: Secured tax claims.

Class 3: Secured claim of the Bank.

Class 4: All unsecured claims, other than those in classes 1, 5, and 6.

Class 5: The Bank's deficiency claim.

Class 6: Claim of North Street Limited Partnership secured by its pre-petition second mortgage on the Property.

Class 7: The interests of the Debtor's general and limited partners.

The bankruptcy court summarized the major features of the Plan, relevant to its confirmation decision as follows:

> (1) The debtor's partners would contribute a total of $6.125 million in new capital to the debtor over the life of the plan, $3 million on the day after the effective date of the plan, and $625,000 on each of the next five anniversaries of the effective date. The payment of the five annual installments would be secured by a continuing letter of credit in the amount of $1,125,000.
>
> (2) Priority and tax claims would be paid in full, within 30 days of the effective date of the plan, from funds currently on deposit.
>
> (3) The trade creditors would be paid in full, without interest, 180 days after the effective date of the plan. Upon confirmation, the insiders would waive the general unsecured claims that they hold (including, apparently, the claims purchased by the general partner).
>
> (4) The bank's secured claim, fixed at $54,544,500 would be paid partly in cash ($1,149,500 within five days of the effective date of the plan), and partly through an interest bearing note, secured by the bank's lien on the

property. Monthly payments would be made on the note, on a thirty-year amortization schedule, and the note would mature in seven years, extendable to ten years at the debtor's option, upon certain conditions. The principal of the note would further be reduced by monthly payments to the bank of the excess cash flow of the property. The note would compensate the bank for its extension of credit in three ways: first, a commitment fee in an amount between $266,975 and $545,000 to be determined by the court; second, fixed "base interest" at a rate 3½ per cent over the rate of U.S. treasury obligations maturing 7 years after the effective date of the plan; and, third, "participation interest" of 50% of the net value of the property, either as realized in a sale, or as appraised at the time of any refinancing.

(5) From the remaining value of the property at the time of sale or refinance, payments would be made in the following order: (a) on the unsecured deficiency claim of the bank, payment in full, without interest; (b) for the new capital contributions, payment in full, with interest at varying rates; (c) on the second mortgage held by the general partner, full payment with 10% simple interest; and (d) to the debtor's partners in proportion to their contribution of new capital.

(6) In the event of any default in making the new capital contributions or in making payments under the note, a deed to the debtor's property, held in escrow by a title company, is to be conveyed to the bank. The plan also has a number of features designed to minimize the

possibility of any future bankruptcy filing interfering with the bank's right to obtain this conveyance.

(Bk. Dec. at 7-8.)

The bankruptcy court acknowledged that this Plan, and indeed, the entire bankruptcy case, was filed by the Debtor primarily to avoid severe tax consequences to the Debtor's partners of a foreclosure sale of the Property. The collective liability of the partners, in the event of foreclosure, is estimated at $20 million.

The general unsecured creditors in the class defined by the Plan voted in favor of the Plan; the only votes against confirmation were those of claims held or purchased by the Bank.

Motion to Dismiss the Appeal

The Debtor moves to dismiss as moot the Bank's appeal on the grounds that the Debtor has already implemented the Plan and substantial confirmation (as defined in section 1101(b)) has occurred. It contends that, under the circumstances of this case, it is no longer possible for the Court to grant meaningful relief to the Bank.

In particular, the Debtor contends that numerous good faith transfers have already occurred that cannot be undone: (1) the investors have acquired equity in the Debtor, which, in turn, has acquired the Property; (2) Rudnick & Wolfe has acquired a leasehold interest in the Property; (3) numerous other payments required under the Plan have been made. Furthermore, the cash advanced by the Debtor's investors, who are not parties to the case, have already been used to make payments under the Plan and cannot be recovered.

Their interests would thus be adversely affected. Rudnick & Wolfe—whose entering into its lease was contingent on confirmation of the Plan and also not a party to the case—would be adversely affected, because it has already given up the opportunity to move to another building and has also spent considerable sums to redecorate its space and acquire new equipment.

The bank contends, to the contrary, that the Debtor overstates the irreversibility of its implementation of the Plan. The Bank simply seeks to foreclose its mortgage. It contends that the return of payments to the trade debt creditors and the real estate tax payments, as well as several other payments, are not necessary for it to pursue a foreclosure. Furthermore, the Bank is in favor of the Rudnick & Wolfe lease extension and would not disturb any aspect of it. The transactions involving the Bank are at the heart of this appeal and can be easily undone: the Bank will return any payments necessary to insure that it has received no more than it would had the Plan not been confirmed and will return any documents it has received under the Plan. The Bank also agrees to leave any post-petition service contracts undisturbed. Moreover, the Bank is prepared to fund the repayment of any amount advanced by the investors, as well as any ancillary amounts necessary to accomplish this.

The Confirmation Order does not involve complex transactions. We are persuaded by the Bank's arguments that, in the event of reversal, the implementation of the Plan can be undone without undue difficulty and without harm to third parties. We therefore deny the Debtor's motion to dismiss the appeal as moot.

Appeal of the Confirmation Order

On an appeal from the bankruptcy court, the district court "may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." 11 U.S.C. Fed. R. Bankr. Proc. 8013 ("Rule 8013"). The district court shall not set aside the bankruptcy court's findings of fact unless clearly erroneous, *In re Tolona Pizza Products Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993), and shall not overturn them so long as they are "plausible in light of the record viewed in its entirety." Rule 8013; *Levinson v. United States*, 969 F.2d 260, 265 (7th Cir.), cert. denied, 506 U.S. 989 (1992) (citing *Anderson v. City of Bessemer City, North Carolina*, 470 U.S. 564, 574 (1985)). Meanwhile, the district court reviews the bankruptcy court's conclusions of law *de novo*. *Meyer v. Rigdon*, 36 F.3d 1375, 178 (7th Cir. 1994); *Woodbridge Place Apartments v. Washington Square Capital, Inc.*, 965 F.2d 1429, 1434 (7th Cir. 1992).

The Bank argues on appeal that the bankruptcy court erred in concluding that the Debtor had established that the Plan satisfied the requirements of 11 U.S.C. § 1129;[2] and that

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[2] Section 1129 states, in relevant part:

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(continued...)

[2] (...continued)

. . . . .

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

. . . . .

(7) With respect to each impaired class of claims or interests—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

. . . .

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of

(continued...)

[2] (...continued)

the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

. . . .

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(continued...)

it erred in entering the Confirmation Order based on that conclusion. In arguing that the bankruptcy court did so err, the Bank raises the following issues:

1. Whether the Bankruptcy Court erred as a matter of law or fact in concluding that the Plan was proposed in good faith as required by § 1129(a)(3).

2. Whether the Bankruptcy Court erred as a matter of law or fact in concluding that the continuation of North LaSalle, the Debtor's sole remaining general partner, in control of the Debtor was in the interests of creditors and consistent with public policy as required pursuant to § 1129(a)(5).

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[2] (...continued)

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

3. Whether the Bankruptcy Court erred in concluding that the Debtor had satisfied the impaired accepting class requirement of § 1129(a)(10).

4. Whether the Bankruptcy Court erred as a matter of law or fact in concluding that the Plan did not unfairly discriminate against [the Bank's] unsecured claim in violation of § 1129(b)(1).

5. Whether the Bankruptcy Court erred as a matter of law in concluding that the unsecured or otherwise unsupported promissory notes of the Debtor's partners could be considered for any purpose.

6. Whether the Bankruptcy Court erred as a matter of law in concluding that the "new value" exception to the absolute priority rule continues to exist under the Bankruptcy Code.

7. Whether the Bankruptcy Court otherwise abused its discretion in finding that the Plan satisfies the "new value" exception to the absolute priority rule.

8. Whether the Bankruptcy Court erred as a matter of law or fact in concluding that the Plan was feasible under § 1129(a)(11), notwithstanding that the Bankruptcy found that the Debtor will experience negative cash flow in years seven and eight of the Plan, which the Debtor itself estimates to be at least $5 million.

9. Whether the Bankruptcy Court erred as a matter of law in concluding that the Plan was feasible under § 1129(a)(11) based on the Plan's provisions providing that a deed conveying the Property to the Bank is to be placed in escrow on the effective date of the Plan and delivered and

recorded upon the occurrence of an event of default under the Plan.

10. Whether the Bankruptcy Court otherwise abused its discretion in finding that the Plan was feasible under § 1129(a)(11).

11. Whether the Bankruptcy Court erred as a matter of law, or otherwise abused its discretion, in concluding that the Plan provides fair and equitable treatment of the Bank's secured claim because the GECC Letter of Intent—the purported basis of the terms and conditions governing the treatment of the Bank's secured claim under the Plan (including the interest rate)—was a "market" proposal.

12. Whether the Bankruptcy Court otherwise abused its discretion in finding that the Plan provides for fair and equitable treatment of [the Bank's] secured claim.

13. Whether the Bankruptcy Court erred as a matter of law by deducting the hypothetical costs of disposition from the value of the Property to determine the amount of [the Bank's] secured claim.

14. Whether the Bankruptcy Court abused its discretion in finding that the Plan satisfied the "best interests" test under § 1129(a)(7) without its providing for the payment of interest on the Class 4 Claims.

(Appellant's Br. at 4-6.)

It is apparent that the Bank raised all or nearly all of these issues before the bankruptcy court, and in substantially the same form. In a lengthy Memorandum of Decision, the bankruptcy court thoroughly explored all of the Bank's objections. In order to affirm the Confirmation Order, we

must uphold the decision of the bankruptcy court on each of these issues. *See, e.g., In re Rusty Jones, Inc.*, 110 B.R. 362, 373 (Bankr. N.D. Ill.1990). We discuss each of the Bank's objections in turn.

I. *Good Faith Proposal of Plan*

The Bank contends that since the primary purpose of the Plan, as found by the bankruptcy court, was to help the debtor's sophisticated investors avoid adverse income tax consequences that they would experience as a result of the Bank's foreclosure of its mortgage, the Plan violates the requirement of section 1129(a)(3) that the Plan be "proposed in good faith and not by any means forbidden by law."

The standards for "good faith" proposal of a plan are set forth in *In re Madison Hotel Associates*, 749 F.2d 410, 425 (7th Cir. 1984). The Seventh Circuit interpreted "good faith" to mean "that there exists 'a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code.'" *Id. (quoting In re Nite Lite Inns*, 17 B.R. 367, 370 (Bankr. S.D. Cal. 1982)). Similarly, the "good faith" requirement "require[s] the bankruptcy court to review the proposed plan for accuracy and 'a fundamental fairness in dealing with one's creditors.'" *Id.* (*quoting In re Rimgale*, 669 F.2d 426, 432-33 (7th Cir. 1982)). "Thus, for purposes of determining good faith under section 1129(a)(3) . . . the important point of inquiry is the plan itself and whether such plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code." *Id.* The *Madison Hotel* court explicitly distinguished the determination under section 1129(a)(3) of whether a plan is *proposed* in good faith from the determination of whether the Chapter 11 petition for reorganization was *filed* in good faith. *Id.* The court thus held that the district court had erroneously construed section 1129(a)(3) when it evaluated

the pre-filing conduct of the debtor as well as the feasibility of the plan itself. Thus, we will not consider the motive of the Debtor or its partners in filing their Chapter 11 petition in determining whether or not its Plan fulfills the good faith requirement for confirmation.

Even were good faith in *filing* an issue, the Debtor's motive to avoid adverse consequences would still not constitute bad faith. *In re Cadwell's Corners Partnership*, 174 B.R. 744, 762 (Bankr. N.D. Ill. 1994) (holding that concern about tax consequences of foreclosure is alone insufficient to establish bad faith). This result also comports with the holding of *In re James Wilson Associates*, 965 F.2d 160, 170 (7th Cir. 1992): "It is not bad faith to seek to gain an advantage from declaring bankruptcy—why else would one declare it?" This was in response to the argument by the principal creditor that the sole purpose of the entire bankruptcy proceeding was to squirrel away the rents where the receiver couldn't get at them. It is difficult to see how this differs materially from the Bank's argument in this case. The Seventh Circuit opined that the clearest case of bad faith would be "where the debtor enters Chapter 11 knowing that there is no chance to reorganize his business and hoping merely to stave off the evil day when the creditors take control of his business." *Id.* In addition, bad faith filing is found where the debtor is able to pay its creditors in the ordinary course, where there is no prospect for reorganization, and where filing is for purposes of harassment. *In re N.R. Guaranteed Retirement, Inc.*, 112 B.R. 263 (Bankr. N.D. Ill.), *aff'd* 119 B.R. 149 (N.D. Ill. 1990).

The Bank's reliance on *In re Love*, 957 F.2d 1350, 1358-59 (7th Cir. 1992) for the proposition that a plan motivated primarily to avoid adverse tax consequences is proposed in bad faith is misplaced. *In re Love* involved a Chapter 13 petition filed by a member of a tax protest group

who had submitted false W-4 forms, and continued to do so after the Internal Revenue Service ("IRS") instructed his employer not to accept them. He also did not file his federal income tax forms for the years 1981 through 1985 until 1986. As result of these and other activities, as well as refusal to pay assessed income taxes, the IRS initiated levies against the protester. He then filed his Chapter 13 petition, as the court found, to avoid paying assessed taxes, much of which, under the circumstances of the case, did not constitute priority claims. *Id.* Unlike that case, the Debtor does not seek to avoid taxes already incurred, but to structure its transactions so as to avoid incurring tax liability. *See In re Sherwood Square Assocs.*, 107 B.R. 872, 876 (Bankr. D. Md. 1989) (holding that a desire to avoid tax consequences by the debtor's partners is not bad faith, in contrast to a situation where the only asset of a debtor is a tax loss).

The Bank's reliance on *In re Castleton Associates Limited Partnership*, 109 B.R. 347 (Bankr. S.D. Ind. 1989) is likewise unavailing. In *Castleton*, the question was whether a Chapter 11 petition was *filed* in good faith pursuant to section 1112(b). Furthermore, the debtor was a partnership whose sole asset was a residential apartment complex that was unable to generate enough income to meet operating expenses. The debtor did not even operate the business, but contracted out to a management company the everyday duties of maintaining and managing the complex. Thus, unlike this case, the debtor really had no business of its own to preserve—merely an investment. *Id.* at 350.

The Bank further argues that the bankruptcy court's factual findings that the Plan was proposed in good faith is clearly erroneous because "[i]t is undisputed that the entire risk of the Plan on creditors falls on" the Bank. It points to the provisions for prompt payment of the full amount of principal to all other non-insider creditors, to the cash flow

shortages in years seven and eight, and asserts that the insider creditors—to the extent that they have any claims—do not expect to receive, and are unlikely to receive, any distribution on their claims and that the Debtor's investors stand to receive no economic benefit from the Property. It argues that the Debtor's partners could have contributed a greater amount of new capital and that the feasibility of the Plan depends entirely on the Bank's willingness to relend excess cash flow payments in years seven and eight. In sum, the Bank contends that the full risk of the Plan is placed on it, not to maximize the value of the estate for creditors, but to allow the Debtor's investors to avoid adverse tax consequences.

Many of the Bank's assertions are raised in other of it's objections and will be addressed more specifically as we discuss each of them below. We will then return to the general fairness issue. The Bank cites no law concerning how risk is to be distributed among *creditors*. Suffice it to say that the Debtor's investors also take on considerable risk through their $3 million cash investment, their execution of notes obliging them to make annual payments of $625,000, their purchase of a letter of credit, and their granting of additional security interests to the Bank in the form of a commitment fee, an initial $1.149 million payment, and to fund the cost of Rudnick & Wolfe's lease extension. Furthermore, the bankruptcy court found that the Bank's risk is considerably less than it seems to argue. The cash shortfall in years seven and eight arise from projected costs in extending the lease of Coopers & Lybrand and will result in an enhanced value to the Property—and the Bank has a right to disapprove lease transactions and not to relend excess cash flow payments. Moreover, the Bank is entitled to automatic transfer of the title of the Property in the event of a default. The Bank's own appraiser testified to the improving market for buildings like the Property; thus, the Bank will enjoy a comfortable equity cushion—as a result both of the increase

in equity and the paying down of the principal on its secured claim.

We conclude that the bankruptcy court's factual finding that the Plan was proposed in good faith is amply supported and is not clearly erroneous.

II. *Continuation of Debtor's Present Management*

Section 1129(a)(5)(A)(ii) requires that the continuation of the Debtor's present management under a plan be "consistent with the interests of creditors and equity security holders and with public policy." The Bank contends that the continuation of the Debtor's management is not in the interests of creditors and public policy because, before filing the petition, these managers failed to use pre-petition rents for timely payment of real estate taxes. The Bank further contends that this failure was motivated solely by a desire to improve the Debtor's bargaining leverage vis-a-vis the Bank. The Bank argues that because nonpayment of real estate taxes constitutes waste under Illinois law, the Debtor's willingness to engage in nonpayment makes continuation of management contrary to the interests of creditors.

The cases relied upon by the Bank do not support its contentions as they apply to this case. In particular, nonpayment of real estate taxes *may* constitute waste if such nonpayment harms the creditors. *Hausmann v. Hausmann*, 596 N.E.2d 216, 220 (1992) (Ill. App. Ct. 1992). Courts have found that nonpayment of taxes constitute waste where such nonpayment is continuous and resulted in repayment of such taxes by the principal creditor after foreclosure or a tax sale of the property in question. *Hausmann, supra; North Am. Security Life Ins. Co. v. Harris Trust & Sav. Bank*, 859 F. Supp. 1163 (N.D. Ill. 1994); *Capitol Bankers Life Ins. Co. v. Amalgamated Trust & Sav. Bank*, No. 92 C 4480, 1993

WL 594103 (N.D. Ill. May 6, 1993), *aff'd*, 16 F.3d 1225 (7th Cir. 1994). In this case, there was no continuous practice of nonpayment of real estate taxes, but rather a single transfer of rental income into an account that remained in the control of the Debtor. The bankruptcy court found that this transfer was an error in judgment—it exposed the Debtor unnecessarily to tax penalties and was unlikely to achieve its intended purpose of advancing settlement discussions with the Bank—but that it is not indicative of a general course of conduct prejudicial to creditors. The Bank points to no facts that would indicate that this finding is clearly erroneous, and we therefore accept it. In fact, the single delinquent installment of real estate taxes has been paid pursuant to section 3.2 of the Plan. Moreover, the difference between the monthly penalties that accrued on the unpaid taxes and the earnings on the Debtor's cash were paid by the Debtor's management company. Thus, neither the Bank nor the Property were injured in any way by the delay in payment.

III. *Artificial Impairment*

Section 1129(a)(10) requires that, if any class of claims are impaired under a plan, at least one of those classes must accept the plan, without including any acceptance of the plan by any insider. Since the Bank did not accept the Plan, the only non-insider class remaining is the class of trade debt claims, which did accept the Plan. The Bank contends that the acceptance of the Plan by this class should be disregarded, because there was no valid reason to impair those claims—they total only $90,000, and the Debtor had more than enough resources to pay them in full, with interest, on the effective date of the Plan.

The Bank relies on *In re Windsor on the River Associates*, 7 F.3d 127 (8th Cir. 1993). In *Windsor*, the debtor, whose sole asset was a 298-unit apartment complex,

proposed a plan that impaired a class of trade creditors by providing for the payment of those claims 60 days after the effective date of the plan. The Eighth Circuit refused to recognize this impairment, holding that "for purposes of 11 U.S.C. 1129(a)(10), a claim is not impaired if the alteration of rights in question arises solely from the debtor's exercise of discretion." *Id.* at 132. The court found that an "arbitrary manipulation" had taken place, "the only purpose" of which was "to ensure approval by at least one 'impaired' class as required by section 1129(a)(10)." *Id.* at 133.

The bankruptcy court read *Windsor* as "requir[ing] the denial of confirmation in any case where it would be possible to structure a plan without an approving impaired class" (Bk. Dec. at 3.8), then discussed the rejection of this rule by the Ninth Circuit Bankruptcy Appellate Panel as unsupported by the language of the Code and as inconsistent with the Code's policy of flexibility in plan formulation. *See In re Hotel Assocs. of Tucson*, 165 B.R. 470, 475 (Bankr. 9th Cir. 1994); *accord, In re Beare Co.*, 177 B.R. 886 (Bankr. W.D. Tenn. 1994). Other courts have confirmed plans over objections of artificial impairment because the debtor showed that the impairment, although not absolutely essential, was desirable for other purposes and not solely to achieve impairment. *In re Duval Manor Assocs.*, 191 B.R. 622 (Bankr. E.D. Pa. 1996); *In re Rivers End Apartments, Ltd.*, 167 B.R. 470, 479 (Bankr. S.D. Ohio 1994). Indeed, in a wide-ranging discussion, the court in *Duval Manor* indicated that the issue of allowing artificially impaired classes under section 1129(a)(10) was a "cutting-edge" issue in bankruptcy today and that courts could be found on both sides of the issue. *Duval Manor, supra,* at 626–29. The court concluded that restricting artificial impairment could itself give rise to a "Pandora's box" of related problems. *Id.* at 629. *See also* Eric W. Lam, *On the River of Artificial and Arbitrary*

Impairment: An Erroneous Analysis, 70 N.D. L. Rev. 993 (1994).

The bankruptcy court found that the trade claims were not impaired solely for the purposes of insuring compliance with section 1129(a)(10). The operating income is not projected to provide sufficient income to pay all unsecured claims in full, with interest. Thus, the debtor had to impair claims. The court found that the Plan's manner of doing so is highly favorable to non-insider claims by providing for payment of the principal of those claims before payment of any insider claims. Though the Debtor could have structured the Plan to provide payment of the trade debt claims in full with interest, doing so would have reduced the amount available to satisfy other claims, including those of the Bank, and would have made confirmation more difficult. (See our discussion of the Bank's fourth objection, *infra*, in regard to treatment of trade debt claims.) This is in marked contrast to the situation in *Windsor*, where the only impairment is a sixty-day delay in payment—thus, no other class could have been affected in any way by the choice to impair. We think, in fact, that the bankruptcy court read *Windsor's* holding too broadly—it does not require the denial of confirmation in any case where it would be possible to structure a plan without an approving impaired class. The *Windsor* court made clear that the only purpose to be served by the proposed impairment before it was to insure an impaired class—it noted that the "[d]ebtor never presented a plausible alternative explanation." *Windsor, supra*, at 133. Given the unsettled nature of the law on this issue—the Seventh Circuit has not spoken—we conclude that the bankruptcy court did not err as a matter of law in finding that the Plan complies with section 1129(a)(10). Furthermore, '[w]hether Debtor manipulated the terms of its plan for purposes of securing confirmation is a question of fact." *Id.* at 132. We conclude that the

bankruptcy court's finding that the trade debt class was legitimately impaired is not clearly erroneous.

IV. *Unfair Discrimination Against the Bank's Unsecured Deficiency Claim*

The Bank contends that the Plan violates section 1129(b)(1), which requires that a plan "not discriminate unfairly . . . with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." In particular, the Bank contends that since its unsecured deficiency claim is not to receive any distribution until the sale or refinancing of the Property—which is not expected for seven or ten years and even then, the court found, the present value of the Bank's distribution does not exceed 16% of the Bank's claim—while the other unsecured non-insider creditors are to receive 100% of the principal amount of their claims on the effective date of the Plan, its deficiency claim is discriminated against unfairly.

At the outset, we note that the Seventh Circuit has interpreted sections 1111(b)[3] and 1122(a)[4] to require that the unsecured deficiency claim of a secured creditor, where the

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[3] Section 1111(b) creates an unsecured deficiency claim of an undersecured creditor for the amount that the total lien exceeds the value of the collateral. Such a creditor may waive its deficiency claim and elect to have its claim treated as secured for the entire amount of the debt.

[4] Section 1122(a) provides that

> a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

debtor's sole asset is fully encumbered, be classified separately from the general unsecured creditors, because the legal rights of such a claimant are different from those of a general unsecured claimant. *In re Woodbrook Assocs.*, 19 F.3d 312, 319 (7th Cir. 1994). Clearly some discrimination between these classes must be permissible. *In re Aztec Co.*, 107 B.R. 585, 588-89 (Bankr. M.D. Tenn. 1989). The critical question then is not whether there is discrimination, but whether such discrimination is unfair.

The Bank relies on *Woodbrook* and *Aztec*. In *Woodbrook*, a provision providing for a 5% distribution to an section 1111(b) unsecured deficiency claim while providing for payment in full to the other unsecured claimants was found to discriminate unfairly. However, as the bankruptcy court noted, the *Woodbrook* court also found that the other unsecured creditors were in fact insiders and it did not discuss its general understanding of unfair discrimination. The bankruptcy court concluded that it is possible to lay a framework for measuring the fairness of a discrimination in Chapter 11 plans in two steps. First, any discrimination must be supported by a legally acceptable rationale, and, secondly, the extent of the discrimination must be necessary in light of that rationale. In this view, the discrimination in *Woodbrook* is unfair because favoring insiders at the expense of the deficiency claim, at least at the extreme disproportionality contemplated in that plan, could not be justified. In this case, the bankruptcy court concluded that the Debtor had provided a compelling rationale for its disparate treatment of unsecured claims: the best interests test as set forth in section 1129(a)(7), which requires that the debtor pay holders of impaired claims as much as they would have received in a Chapter 7 liquidation. The trade creditors in this case would have been paid in full under Chapter 7, while the Bank's unsecured deficiency claim would receive nothing. Thus, in order to be confirmed, the Plan must provide for full payment

of the trade debt. Since the Debtor cannot then pay all of its creditors in full, at least some must be paid less than their full claim—as long as they receive at least as much as they would have received under Chapter 7. The bankruptcy court next found that the discrimination in the Plan is narrowly tailored to meet the requirements of the "best interests" test: the trade creditors receive only the principal amount of their claims and all insider claims are either waived or subordinated to the Bank's deficiency claim. The bankruptcy court concluded that this treatment is not unfair.

The Bank asserts that *Aztec* controls in this case, in its rejection of the proposition that the requirements of the "best interests" test provide a rational basis, in and of themselves, for discriminating against a deficiency claim that arises solely by virtue of section 1111(b). It further asserts that the Seventh Circuit itself relied on this holding in its reliance on *Aztec* in *Woodbrook*. The Bank both misreads *Woodbrook* and misapplies *Aztec* to this case. *Aztec* is cited in *Woodbrook* in support of the holding of the latter that a Plan that discriminates by providing *de minimis* treatment to a deficiency claim while providing substantially more favorable treatment to insider claims, discriminates unfairly and cannot be confirmed. More importantly, the *Aztec* court found an additional basis for finding the discrimination to be unfair where the *de minimis* treatment of the deficiency claim—in relation to insider claims—was *justified* on the basis that the deficiency claim would receive no more under a chapter 7 liquidation. In contrast, the Bank's deficiency claim does receive more favorable treatment than it would in a chapter 7 liquidation, and its failure to receive even better treatment is not at the expense of insider claims, but because the trade debt claims *must* be treated at the level they are in order to satisfy the "best interests" test. We conclude that the bankruptcy court properly found that the Plan does not

unfairly discriminate against the Bank's unsecured deficiency claim.

IV. *Unsecured Promissory Notes*

Under the Plan, the Debtor's equity holders are to contribute $6.125 million in new capital in the form of $3.0 million in cash the day after the effective date of the Plan and $625,000 annually for five years. The five annual installments are secured by a continuing letter of credit in the amount of $1,250,000. The Bank contends that this constitutes only $4.1 million of new value in the form of money or money's worth, because the remaining $1,875,000 is not covered by the letter of credit and is therefore in the form of unsecured promissory notes. The Bank contends that the bankruptcy court erred when it considered the value of these unsecured promissory notes in determining that the interest rate to be paid on the Bank's secured claim in determining that the Plan is feasible.

The bankruptcy court found that although the notes are unsecured, there is "de facto" recourse: the partners will suffer a $20 million tax liability if the property is sold in a foreclosure sale and thus have a substantial incentive to meet their obligations under the notes, and the letter of credit securing payment of their contributions is not fully released until all five of the annual payments are made. These factors provide sufficient assurance that the payments will be made.

The Bank relies on several cases in support of its contention that unsecured promises to make future payments do not constitute money or money's worth. *See In re Snyder*, 967 F.2d 1126, 1131 (7th Cir. 1992); *In re 8315 Fourth Avenue Corp.*, 172 B.R. 725, 737 (Bankr. E.D.N.Y. 1994); *In re Yasparro*, 100 B.R. 91 (Bankr. M.D. Fla. 1989). These cases, however, all discuss whether unsecured promissory

notes can be considered in assessing the substantiality of a proposed contribution of new value for purposes of the new value exception to the absolute priority rule, which we discuss below, and not whether they can be considered for any other purpose—including determinations of feasibility or of interest rates to be paid on secured claims, as here. The Bank has not cited any cases supporting its assertion that promissory notes may not be considered in these contexts. The bankruptcy court specifically did not consider the promissory notes covering the last three annual payments in determining that the infusion of new capital is sufficient. We conclude that the court did not err as a matter of law in considering the unsecured promissory notes in determining the interest rate to be paid on the Bank's secured claim and that its factual finding that the circumstances surrounding the issuance of the unsecured promissory notes are sufficient to insure payment is not clearly erroneous.

IV. *The "New Value" Exception to the Absolute Priority Rule*

Section 1129(b)(2)(B) sets forth the minimum standards that a plan must meet to satisfy the "fair and equitable" requirement. This test, known as the "absolute priority rule," requires that unless each claim in a non-accepting class of unsecured claims is paid in full on the effective date of the plan, the plan must provide that "the holder of any claim or interest that is junior to such class will not receive or retain under the plan on account of such junior claim or interest in any property." 11 U.S.C. § 1129(b)(2)(B).

The Bank contends that the Plan violates this requirement, because, although its deficiency claim will not receive full payment, the holders of partnership interests in the Debtor—which of course are junior to the Bank's deficiency claim—do receive property in the form of equity.

The bankruptcy court found that this equity retained by the debtor's partners is on account of the new capital that they are to contribute under the Plan, and that this retention of ownership interest is permissible under a "new value" exception to the absolute priority rule.

The Bank, while conceding that the existence of the "new value" exception is an open issue in the Seventh Circuit, argues that the most persuasively reasoned Seventh Circuit discussion of the issue indicates that the court, in an appropriate case, would not recognize the exception. The Bank relies principally on *Kham & Nate's Shoes No. 2 v. First Bank*, 908 F.2d 1351, 1360-62 (7th Cir. 1990), which declined to reach the question of a new value exception because the proposed contribution by the debtor would have been insufficient in any case. The *Kham* court, nevertheless, indicated that it thought the new value exception was unlikely to survive, because the language of the Code strongly suggests that such an exception does not exist and because Congress was not receptive to a proposal by the Bankruptcy Commission to codify the exception when it recodified the bankruptcy Code in 1978. *Id.* at 1361-62.

On the other hand, the court, in *In re Snyder*, 967 F.2d 1126, 1128-31 (7th Cir. 1992), while again declining to rule on the question because of an inadequate proposed contribution, looked favorably upon the existence of the new value exception. It pointed to a strong history of the exception in judicial decisions that Congress did not clearly overrule, as well as strong policy arguments for its retention, noting in particular situations where owner participation in a reorganized entity would be particularly valuable in its operation, or where the necessary new capital would be otherwise unavailable. Furthermore, the *Snyder* court cited with approval several commentators who reasoned that the new value exception is better seen as a "corollary" to the

absolute priority rule rather than an "exception" to it. In particular, the rule bars old equity from retaining or receiving an interest "on account of" its prior ownership. But when necessary new capital is provided, the source of the retained interest is not the prior equity interest, but rather the new contribution. Thus, such a "corollary," not being an exception, survived the 1978 re-enactment of the Code. *Id.* at 1130.

More recently, the Ninth Circuit, after a long and detailed examination, held that the new value exception is valid. *In re Bonner Mall Partnership*, 2 F.3d 899, 905-17 (9th Cir. 1993). The bankruptcy court found the arguments advanced in *Bonner Mall* to be persuasive. It summarized them as follows:

> (1) the language of Section 1129(b)(2)(B) cannot unambiguously be applied in the context of a contribution of new value by the debtor's owners; (2) given this genuine ambiguity, it is appropriate to look at pre--Code practice for aid in interpretation; (3) prior to the adoption of the Code . . . the availability of the "new value" approach to reorganization was generally recognized; (4) nothing in the legislative history of the Code, or the language of the Code itself, gives any clear indication that Congress intended to eliminate the new value approach.

(Bk. Dec. at 28.) Furthermore, the Ninth Circuit found that the new value exception is consistent with the underlying policies of Chapter 11 of the Code. *Bonner Mall, supra*, at 915-17. In particular, permitting debtors to contribute new capital, which may be otherwise unavailable, increases the amount available to use in reorganization and in paying

creditors; it often allows control and management to remain with the old owners, who are often in the best position to re-establish a profitable business. Furthermore, it enhances the primary purposes of chapter 11 of successful debtor reorganization and maximization of the value of the estate *(see NLRB v. Bildisco & Bildisco,* 465 U.S. 513, 527 (1984)). *Id.* at 915-16.

The most recent Seventh Circuit case on the subject, while again declining to rule, looks favorably upon its continued vitality. *In re Wabash Valley Powers Ass'n*, 72 F.3d 1305, 1314-15 (7th Cir. 1995). The court's observation that the "common thread running through cases involving the absolute priority rule is a refusal to allow prior equity owners to trade on their 'insider' status to acquire new equity for less than its value." *Id.* at 1315. The *Bonner Mall* court, likewise, found this to be a concern and concluded that a properly applied new value exception was the best way to avoid such "insider" deals, or collusion, which are not strictly prohibited by the language of the Code. *Bonner Mall, supra,* at 916. This suggests that the "new value exception," rather than being a ministerially applied judicial appendage to the Code, is best seen as an opportunity for the bankruptcy court, in its discretion, to make use of an opportunity for new capital contributions by the debtor in fashioning a workable and equitable plan of reorganization.

In this case, the new value contributions do not result in equity holdings by the Debtor's partners that are of greater value than the contributions, the contributions do add value to the estate, and they do enhance the ability of creditors to realize their claims. Furthermore, the new capital contributions were necessary to the formulation of a successful Plan. We conclude that the bankruptcy court properly found that a new value exception does exist, and that it properly applied the exception in confirming the Plan.

VII. *Substantiality of New Capital*

The Bank argues that even if the "new value" exception continues to exist, the new capital contribution under the Plan is insufficient to satisfy the exception. The new capital contribution—$3.0 million in cash and a letter of credit posted in the face amount of $1.25 million—was determined by the bankruptcy court to have a present value of $4.1 million. This amount equals 7.5% of the Bank's secured claim and 7% of the total unsecured claims. The Bank first contends that, when considered merely as a percentage of senior claims, the new capital contribution is not substantial. *See Woodbrook, supra* at 320 (holding that a 3.8% contribution is not substantial); *Snyder, supra* at 1131 (holding that a contribution equal to 2.7% of total unsecured debt or 3.3% of the claim of a single unsecured creditor is not substantial).

The bankruptcy court responded to this argument by pointing out that the total unsecured claims are not relevant here, because many of those claims belong to the general partner or an entity that it controls and have been either waived or subordinated to the claims of the bank. Furthermore, the insider trade debt is paid in full under the Plan. Thus, the only unsecured claim that is being involuntarily primed by the new capital is the Bank's deficiency claim. The new value contribution equals about 10.7% of that claim. More importantly, the *Snyder* court itself stated that

> We cannot say that the determination as to whether an infusion of new capital is "substantial" will always hinge on a comparison to the total amount of unsecured debt. There is no mathematical formula for resolving the substantiality issue, and it will depend on the circumstances of the individual case.

Id. at 1131-32. The bankruptcy court concluded that, in this case, the new capital contribution is substantial both in absolute terms and in its impact on this case:

> The $4.1 million minimum value of the contribution in this case dwarfs the $30,000 involved in *Snyder* and the $100,000 in *Woodbrook*. It constitutes over 20% of the tax liability the partners hope to avoid. And, most significantly, the total contribution package, however valued, is substantial enough to make possible a commercial loan on the debtor's property consistent with the terms of the proposed plan. That plan, in turn, offers a substantial (16%) return on the bank's deficiency claim. The new value contributions proposed by the September 11 plan are not mere tokens, but genuine contributions to the proposed plan.

(Bk. Dec. 30-31)

The Bank contends, however, that the true measure of the substantiality of new capital contribution is whether it makes a plan feasible. *See, e.g., Woodbrook, supra,* at 320; *Snyder, supra*, at 1131 ("The substantiality requirement" means "that an infusion of new capital must be necessary to the success of the undertaking."). It then contends that the proposed new capital contribution in this case is insufficient to render the Plan feasible, because it does not sufficiently counter the projected net cash flow shortfalls in years 2002 and 2003. On the contrary, the bankruptcy court was well aware of the shortfalls in years 2002 and 2003 and of the various devices in the Plan that make the success of the Plan very likely. *See* our discussion of the Discretionary Cash Flow Readvance, *infra*. The determination of whether new capital contributions are sufficient to satisfy the exception to

the absolute priority rule is a factual one, depending on all the circumstances of the case. *See Woodbrook, supra*, at 320; *Snyder, supra,* at 1131. The bankruptcy court has thoroughly considered the circumstances of this case in determining that the new capital contribution is sufficient. We conclude that its finding is not clearly erroneous.

VIII. *Discretionary Cash Flow Readvance*

The bankruptcy court found that, due to anticipated expenses in connection with the renewal of the lease of the Debtor's largest tenant, the projected cash flow in year seven would not be sufficient to make the required debt service, and that this situation continues in year eight, though to a much smaller extent. In the ninth and tenth years, projected cash flow would once again substantially exceed the amount needed for debt service. This cash flow shortfall would be funded by the Debtor's request that the Bank relend the necessary moneys from the amounts it will have received during years one through six in the form of excess amortization payments, i.e., payments to the Bank from excess cash flow over and above the regular monthly amortization payments. The Bank contends that because this readvance feature is wholly discretionary with the Bank, the necessity of this readvance renders the Plan infeasible.

The bankruptcy court concluded that the Debtor's inability to force a loan from the bank does not imply failure of the Plan. Rather, the court found that it likely that the Bank would make the loan willingly, because

> [t]he bank would have enjoyed six years of successful operation of the property, and would, at the time of the request for relending, have a debtor with stable income prospects and a defined short term cash flow shortage. Not only would

the bank be given a generous return on the short term lending, the ultimate effect of the lending would be to increase the debtor's equity in the property, which equity would inure completely to the bank through participation interest and payment of its unsecured deficiency claim.

Alternatively, the debtor would have the option of selling the property and prepaying the loan without penalty. The experts of each party testified to an improving market for office buildings in the Chicago central business district.

Finally, if the anticipated cash shortfall in the seventh year of the plan cannot be made up by the debtor, there will still be no 'liquidation, or the need for further financial reorganization of the debtor.' The debtor's plan itself provides for a consensual transfer of the property to the bank in the event of default, and, this feature of the plan is likely to be enforced in any subsequent bankruptcy proceeding.

(Bk. Dec. at 41-42.)

The Bank contends that the bankruptcy court's finding that the Bank would make the loan willingly is clearly erroneous because it overlooked several material circumstances that the Bank contends are more likely to be relevant at that time: (1) the Rudnick & Wolfe lease extension will have only several years remaining, and thus the property will face a significant tenant rollover risk; (2) the court's prediction as to the future real estate market in general and as to the Property in particular may prove incorrect, and (3) the Debtor's past history of intentional failure to pay real estate

taxes is indicative of possible future behavior prior to impending maturity of the loan extension.

The feasibility requirement of section 1129(a)(11) is that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." Thus, the "standard is whether the plan offers a reasonable assurance of success. Success need not be guaranteed." *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). Furthermore,

> [a] plan meets this feasibility standard if the plan offers a reasonable prospect of success and is workable. The prospect of financial uncertainty does not defeat plan confirmation on feasibility grounds since a guarantee of the future is not required. The mere potential for failure of the plan is insufficient to disprove feasibility.

In re Patrician St. Joseph Partners Ltd. Partnership, 169 B.R. 669, 674 (D. Ariz. 1994) (citations omitted). The bankruptcy court relied on these standards in concluding that the debtor had established the feasibility of the Plan.

The Bank's objections, while reasonable, are primarily hypothetical, and constitute merely disagreements with the inferences drawn by the bankruptcy court. Furthermore, by the seventh year, the principal balance of the Bank's secured loan will have fallen to about $41.5 million, while the value of the Property is projected to have increased to considerably more than the present $55.8 million. This would permit a sale or refinancing for an amount more than enough to pay the Bank's secured claim in full. The Debtor also points out

that, (1) even in the cash flow shortfall years, net operating income will still exceed debt service on the Bank's secured loan, making default a remote possibility; (2) even in the event of a default, the Bank would automatically obtain title to the Property; (3) the Bank's apparent indisposition to make future readvances ignores the acknowledgements of its own counsel that the Bank would be subject to the duty of good faith in considering the requests; and (4) the Rudnick & Wolfe lease does not expire until 2007, five years after the cash flow shortfall years, greatly minimizing the fears of a rollover risk in 2002.

We conclude that, though there might be room for a difference of opinion, the bankruptcy court's finding that the discretionary nature of the relending feature of the Plan does not render the Plan infeasible is not clearly erroneous.

IX. *Property Conveyance Features*

The Bank contends that the bankruptcy court erred when it concluded that the Plan's provision for a consensual conveyance of the Property to the Bank in the event of a default negates any feasibility concerns because of the possibility of a Chapter 11 case being filed before the Debtor goes into a default. Though this might not normally be a negligible concern, it is greatly minimized in this case, because, as set forth in section 5.3(b) of the Plan, Mark W. Wilkow, one of the Debtor's principals, covenants to pay the Bank $10 million personally if he causes the Debtor to file a voluntary bankruptcy petition that blocks the transfer of the Property to the Bank.

The Bank also expresses doubt as to the enforceability of such a conveyance provision. It cites no cases indicating that such a provision might not be enforceable. On the contrary, at least one such conveyance provision has been upheld on

appeal. *In re Billy Ray Eubanks*, No. CIV A 89-3426, 1990 WL 128208 (E.D. La. Aug. 28, 1990) (holding that a plan that provides for the transfer of the debtor's assets to a court-appointed receiver for liquidation and distribution of assets in the event of default makes the plan feasible for the purposes of section 1129(a)(11)). We conclude that the bankruptcy court's finding that the property conveyance features of the Plan make the Plan feasible is not clearly erroneous.

X. *Concrete Plan for Sale*

The Bank contends that in the absence of a concrete proposal for a sale or refinancing of the Property during the term of the Plan, the bankruptcy court abused its discretion in finding that the Debtor would be able to sell or refinance in either year seven or ten, in order to pay the Bank's claim. The only support for this contention cited by the Bank is *In re 8th Street Village Limited Partnership*, 88 B.R. 853, 858 (Bankr. N.D. Ill. 1988). In that case, the debtor, which owned as its sole asset a shopping mall in Boise, Idaho, proposed a plan that included the sale or refinance of the mall in nine years. The court found that without a concrete plan for such sale or refinance, the plan was not feasible. However, the circumstances in that case differed significantly from the instant case. The operations of the mall were unable to generate sufficient income to service current debt, and there were no realistic prospects of a turnaround. In addition, the principal office tenant was about to vacate. The debtor's plans for improvement of its operations were found by the court to be speculative, and the testimony of its expert witness as to an improving market was not found credible. In short, the court concluded that increased competition would most likely make the debtor's projection of a turnaround little more than "hopes and dreams." In those circumstances, the court reasonably concluded that concrete

proposals for a sale or refinance of the mall would be required for confirmation of the plan. *Id.*

In the instant case, to the contrary, the income from the Property is sufficient to service current debt, with the exception of the cash flow shortfall in years seven and eight—already adequately dealt with; the vacancy rate is extremely low and is not expected to be a serious concern; and credible expert testimony on both sides supports an improving market for buildings such as the Property. In these circumstances, we conclude that the bankruptcy court properly found that the intention to sell or refinance the Property in seven or ten years, even without a concrete current proposal, is sufficient to make the Plan feasible.

XI. *GECC Letter of Intent*

Once the amount of the Bank's secured claim was fixed, it was necessary that the Bank be compensated for not receiving the full amount of its claim on the effective date of the plan by receiving a market rate of interest on its claim. Section 1129(b)(2)(A); *In re James Wilson Assocs.*, 965 F.2d 160, 172 (7th Cir. 1992); *In re Bryson Properties, XVIII*, 961 F.2d 496, 500-01 (4th Cir. 1992). The bankruptcy court found that an appropriate market rate of return must be at least the discount rate. (Bk. Dec. at 13-16.) In determining whether the Plan provided for a market rate of return, the court noted that the compensation offered to the Bank is not a flat interest rate. Instead, it consists of three elements: a loan origination fee of between $266,975 and $545,000; fixed base interest at 3.5% over the rate earned by treasury obligations maturing seven years from the effective date of the Plan; and a 50% participation in the net proceeds of any sale or refinancing. These allow the Bank a total rate of return on its secured claim of about 12%. (Bk. Dec. at 17-18.)

The bankruptcy court found convincing evidence presented by the Debtor that this transaction is acceptable in the market. Robert Walter, a regional vice-president of General Electric Capital Corporation ("GECC") prepared a letter of intent outlining the terms under which GECC would consider financing the Property.[5] With one exception, the terms of the letter of intent are the same, or more favorable to the Debtor, than the terms of the new note proposed in the Plan.[6] The bankruptcy court accepted Walter's testimony and concluded that the Plan does provide a market rate of return to the Bank on its secured claim.

The Bank offers five reasons why the GECC letter of intent should not be accepted as adequate evidence of a market rate of return: (1) the letter of intent was not a binding commitment, though Mr. Walter testified that he thought that it would receive senior management approval; it had not yet gone through the review process; (2) GECC had

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[5] The Debtor did not pursue a commitment from GECC, because the Bank indicated it would not accept a cash payment of its secured claim in the amount found by the bankruptcy court, and furthermore, if the Debtor had proposed such a cash out, the Bank would have had the option of having its entire claim treated as secured under § 1111(b).

[6] The one exception is that the GECC letter of intent calls for a flat 1% loan origination fee—$533,950, while the Plan calls for a fee of $266,975, or such greater amount as the court may determine up to 1% of the Bank's secured claim—$545,000. The reason for the smaller fee in the Plan is that the Bank, as a current lender to the Property, would not need to engage in such an extensive due diligence as GECC would. Moreover, even with the reduced origination fee, the Plan still provides a greater overall return to the Bank than the GECC letter of intent would provide to GECC.

not made other comparable loans in the Chicago central business district; (3) GECC is not a dominant player in the real estate debt market; (4) certain of the Debtor's affiliates have enjoyed a previous association with GECC on the strength of four prior and one pending transaction; and (5) other players in the market are looking for 15-25% returns.

The bankruptcy court found, to the contrary, that GECC is indeed a major lender to single asset real estate projects and has expertise bearing precisely on issues relevant to a market rate of return on the note proposed in the Plan. Furthermore, the court found that the rates of 15-25% rates of return sought by the players referred to by the Bank's expert were on properties subject to much greater cash flow risk than is the Property. Though the court did not specifically address the remaining objections in its decision, it was well aware of them and nevertheless found, after considering testimony from experts for both sides, that the Plan provides a market rate of interest to the Bank on its secured claim. We conclude that this finding is not clearly erroneous.

XII. *Deferred Participation Interest*

The Bank contends that its being made to wait until after the Property is sold or refinanced to receive its participation interest constitutes negative amortization. It asserts, without elaboration, that such treatment is impermissible under the circumstances. The Bank provides no reasons why such treatment is impermissible other than citation to a case, *In re 641 Assocs., Ltd.*, 140 B.R. 619, 613 (Bankr. E.D. Pa. 1992), which merely noted that use of negative amortization had been permitted in rather few instances. On the contrary, the bankruptcy court found that the participation interest feature in the Plan does not constitute negative amortization, accepting testimony to that effect by Mr. Walter, who had

included a similar feature in the GECC letter of intent. We conclude that the bankruptcy court's finding is not clearly erroneous, particularly in view of the Bank's failure to provide any reasoning why such a finding should be considered incorrect.

XIII. *Deduction of Disposition Costs*

Since the bank did not elect, pursuant to section 1111(b), to have its total claim treated as secured, its claim must be bifurcated under section 506(a). Thus, the Bank's secured claim is equal to the value of its interest in the collateral. In determining the value of the Bank's collateral, the bankruptcy court reduced the gross reversionary value by the costs the Bank would incur in converting its interest to cash. The Bank does not object to the amount of such disposition costs as found by the court, but asserts that as a matter of law, it is improper to consider such costs in determining the value of the property.

The relevant statutory language is:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . . .

Section 506(a). The bankruptcy court noted that courts initially relied primarily on the first sentence of section 506(a)

and held that disposition costs should routinely be deducted in arriving at a value for secured property because the creditor would ordinarily obtain the value of its interest only after a wholesale transaction or foreclosure sale. (Bk. Dec. at 11.) Later courts, however, placed more emphasis on the second sentence, and held that valuation depends on the debtor's plans for use or disposition of the collateral. Thus, unless the debtor plans to liquidate the collateral, it should be valued at its retail, or replacement, value rather than its wholesale or foreclosure value. *See, e.g., In re Rash,* 62 F.3d 685, 685-87 (5th Cir. 1995), *reh'g en banc granted,* 68 F.3d 113 (1995); *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72 (1st Cir. 1995); *In re Trimble*, 50 F.3d 530 (8th Cir. 1995). As a matter of fact. these three cases cited in support of the Bank's position did not consider the issue of disposition costs as such, but were concerned with whether retail or wholesale value is the proper measure, the difference between which involves much more than merely disposition costs. Only *Trimble* mentions "costs of sale" explicitly. *Trimble, supra* at 531.

The bankruptcy court was not persuaded that the view espoused by these cases is the best reading of section 506(a). It followed the view of the dissent in *Rash,* which argued that in order to give effect to all the statutory language, the value of the secured claim should be measured—as required by the first sentence of section 506(a)—by the extent of the "creditor's interest" in the collateral. Unless the creditor can use the collateral in an ongoing concern, its interest is measured by what it can realize when reducing the property to cash. In this case, the creditor is a bank—it would not operate the Property as an owner. Indeed, the Bank has already stated its firm intention to foreclose. As the bankruptcy court realized, there is no reason to suppose the bank would not be able to sell the property for its fair market value. Thus it is entitled to retail value, as required by *Rash,*

Trimble, and *Winthrop, supra*, rather than wholesale or forced foreclosure value. However, in order to realize the fair market value, the Bank would incur disposition costs, and the court took those into account in valuing the property.

Because the decision in *Rash* is currently scheduled for *en banc* rehearing, and because the reasoning of both *Trimble* and *Winthrop* have been rejected by more recent bankruptcy decisions, *see In re Madison,* 186 B.R. 182 (Bankr. E.D. Pa. 1995) (valuing collateral to be retained and used by debtor at average of wholesale and retail value); *In re Hoskins,* 183 B.R. 166 (Bankr. S.D. Ind. 1995) (same), the issue of how to value collateral retained by a debtor is clearly not settled. Our review of the relevant cases leads us to agree with the conclusion of the bankruptcy court that subtracting disposition costs from the fair market value in arriving at a valuation for the Bank's interest in the Property is consistent with the language of section 506(a) and is not inconsistent with the concerns underlying the decisions in *Rash, Trimble,* and *Winthrop, supra.*

XIV. *The "Best Interests" Test*

The Bank contends that the Plan does not satisfy the "best interests" test of section 1129(a)(7) with respect to dissenting class 4 claims. Section 1129(a)(7) provides that if the holder of a claim impaired under a plan of reorganization has not accepted the plan, then such holder must "receive . . . on account of such claim . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive . . . if the debtor were liquidated under chapter 7 . . . on such date." The Bank does not contest that its deficiency claim meets this test, because it would receive nothing on account of that claim in a chapter 7 liquidation. The Bank also has trade claims in class 4, however, which are to be paid in full under the Plan *without*

interest. The Bank contends that under a chapter 7 liquidation, these claims would be paid in full *with* interest from several sources, including cash on hand and/or from the resources of the Debtor's general partners pursuant to section 723.

The order of distribution of a debtor's property under a chapter 7 liquidation is governed by section 726, which distinguishes the "payment of claims" (section 726(a)(l)–(4)) from the "payment of interest . . . on any claim paid under paragraph (1), (2), (3), or (4) of this subsection" (section 726(a)(5)). Section 726(a) provides that in the event of a deficiency of property of a partnership "to pay in full all claims which are allowed in a case under this chapter," the trustee shall have a claim against a "general partner to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency." The bankruptcy court found that the plain meaning of this provision affords the trustee a claim against a general partner only for payment of a claim, not interest on the claim. The Bank cites only *In re Gramercy Twins Associates,* 187 B.R. 112, 125 (Bankr. S.D.N.Y. 1995) in support of its contention that the requirement of section 723(a) for the payment in full of all claims includes interest on those claims pursuant to 726(a)(5). The *Gramercy Twins* court summarizes at some length the assertions of the objecting creditor, including, among many others, the assertion that payment in full under section 723 includes interest. The court did not discuss that assertion however, because it concluded that the "best interests" test was not met in the plan before it on other, more substantial, grounds.

The Bank has not cited any decisions contrary to the bankruptcy court's interpretation of "claims" in section 723(a), nor has our research revealed any. Although we are not persuaded that the language of section 723(a) is as plain

as the bankruptcy court thought, we do agree that the clear distinction drawn by section 726(a) between "claims" and "interest" on claims makes it most likely that the reference to "claims" in section 723(a) does not include interest. We therefore conclude that the bankruptcy court correctly found that the Plan satisfies the "best interests" test.

We return to the Bank's concerns that it is not treated fairly. The gist of the Bank's position seems to be that it is an innocent party—the lender of funds that enabled the Debtor to invest in an office building, or more accurately, fifteen floors of an office building. The Debtor, or its partners, made a bad investment, because the Property lost value as a result of a downturn in the real estate market, and they stand to lose $20 million in taxes as a result. The Bank has also suffered a loss in the form of decreased value in the collateral for its nonrecourse loan. The Bank contends that it should be allowed to foreclose on the Property and take out whatever value is left in the building, while the Debtor's partners should be made to accept their tax loss—after all, they are the ones that made the bad investment. To be made to continue a relationship with the Debtor, at a risk greater than it would like, and not have its money made available to it now, so that the Debtor's partners can avoid their tax loss, is simply unfair.

The Bank's argument is an appealing one. But the reality of the situation is not so simple. The Bank argues throughout that it is not even the Debtor that wants to avoid a tax loss, but its partners, as if that somehow makes the situation even more egregious. But that is no more than an artifact of the tax code—all tax consequences of a partnership fall on its partners. Furthermore, as we have discussed above, a desire to avoid adverse tax consequences is a perfectly valid reason to seek protection under the Bankruptcy Code. Yes, the Debtor's partners made a bad investment.

But so did the Bank. Its lending of funds to purchase real estate is just as much an investment as the Debtor's purchase. Surely, the Bank thoroughly investigated the real estate market in general, as well as all relevant aspects of the Property, before making the loan. As it turned out, the downturn in the market was unforeseen. Whether it should have been foreseen we will not speculate. The fact is, neither party—both sophisticated players in their fields—did foresee it. The loss in value of the Property was not due to poor management or unsound business practices. All indications are that the Property itself is a prime piece of real estate and has been managed in an exemplary fashion. The loss was due to factors entirely beyond the control of either Debtor or Bank. Now the Bank wishes to cash out and let the Debtor (or its partners) sink.

The chief obstacle for the Bank is the Bankruptcy Code. Unless it can defeat the decision by the bankruptcy court to confirm the Debtor's Plan, it will not be able to cash out—at least not yet. The better view is to realize that chapter 11 reorganization is a collective remedy, designed to find the optimum solution for all parties connected with a business—not solely the for business itself, and not solely for its creditors. Without the Debtor's Plan, the Debtor's partners will surely take a bath. With the Plan, the prospects of the Bank's taking a bath are remote, perhaps a little greater than otherwise, but not much, and in fact, the Bank—though it asserts it does not want the Plan—stands to gain more than it would through a foreclosure now. What would the Bank do with the proceeds of an immediate foreclosure? Undoubtedly, it would lend the money in the form of mortgages not very different from the loan it now has—and is forced to continue to have—with the Debtor. Its income would be roughly the same. So it has not lost much, if anything. The Bank counters that it is made to bear a greater risk than it would like. Perhaps. But, the Debtor has chosen

to seek protection against a much more certain loss—as it is entitled to under the Bankruptcy Code—and the bankruptcy court has determined, after a thorough examination of the relationship and the factors that impinge on its future, that the Bank's risk, under the confirmed Plan, is little different from what it would be in a more normal lending relationship. So much is true if the Plan is a workable one. That brings us to the second part of our summary.

In order for a plan to be confirmed, it must meet all of a rather large number of conditions that are set forth in section 1129. These conditions are designed not only to insure that a plan will work, but that it meets minimum standards of fairness for all participants. The Bank has challenged the bankruptcy court's order confirming the Plan on the basis of most of these conditions, and most of the Bank's objections are credible. That is perhaps not surprising. Any debtor in bankruptcy will have limited resources and will accordingly find it difficult to meet all of the conditions of section 1129. If a debtor could easily meet all of them, it probably has sufficient resources that it need not have filed a petition under chapter 11. Nevertheless, plans of reorganization are often confirmed. As is clear from our examination above of the many decisions challenged by the Bank, bankruptcy courts are given a great deal of discretion in determining whether or not to confirm a plan. All that is required is that the conditions of section 1129 are reasonably met and that the plan has a reasonable likelihood of success. Our review of this Plan leaves us with the clear overall impression that, even though one may reasonably quibble with the bankruptcy court's conclusions here and there, the Plan has a high likelihood of success and is fair to all participants, even though it may not be to the Bank's liking. It is also apparent from the wealth of case law that has been asserted in this appeal that those plans that are not confirmed, or whose confirmation is reversed on appeal, are

overwhelmingly plans that very obviously will not work. That is not true of this Plan. Therefore, we affirm the bankruptcy court.

Appeal of Denial of Relief from Stay and Conversion

The Bank also appeals from the bankruptcy court's denial of its motion for relief from the automatic stay pursuant to section 362(d) and its motion to convert the Debtor's chapter 11 case to a case under chapter 7, or in the alternative, to dismiss the chapter 11 case pursuant to section 1112(b). Its only argument is that reversal of the Confirmation Order requires reversal of the denials of the two motions. Because we affirm the Confirmation Order, we also affirm the bankruptcy court's denial of the Bank's motion for relief from stay and of its motion for conversion or dismissal.

Conclusion

For the reasons set forth above, the Debtor's motion to dismiss the Bank's appeal as moot is denied; the bankruptcy court's order confirming the Debtor's second Amended Plan of Reorganization Dated September 11, 1995 as modified is affirmed; and the bankruptcy court's orders denying the Bank's motion for relief from the automatic stay and denying the Bank's motion for conversion are affirmed.

ENTER:

/s/ Paul Plunkett
UNITED STATES DISTRICT JUDGE

DATED: April 30, 1996

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

BANK OF AMERICA ILLINOIS,
Appellant,

vs.

203 NORTH LASALLE STREET PARTNERSHIP,
Appellee.

JUDGMENT IN A CIVIL CASE

CASE NUMBER:
96 C 0238 (95 B 4998)

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to a hearing before the Court. The issues have been heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED the Debtor's motion to dismiss the Bank's appeal as moot is denied; the bankruptcy court's order confirming the Debtor's second Amended Plan of Reorganization Dated September 11, 1995 as modified is affirmed; and the bankruptcy court's orders denying the Bank's motion for relief from the automatic stay and denying the Bank's motion for conversion are affirmed.

April 30, 1996
Date

H. Stuart Cunningham
Clerk

(By) Deputy Clerk

APPENDIX D

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
203 North LaSalle Street Limited Partnership,	)	**Bankruptcy Case No. 95 B 4998**
Debtor.	)	

MEMORANDUM OF DECISION

This single asset Chapter 11 case is before the court for determination of whether the debtor's Second Amended Plan of Reorganization, dated September 11, 1995 (the "September 11 plan"), should be confirmed. Based on the facts adduced at the hearings on this matter, and for the reasons set forth below, the court finds that the plan generally satisfies the requirements of 11 U.S.C. § 1129 and that confirmation is appropriate, subject to a minor modification.

Jurisdiction

The confirmation of a plan of reorganization, as a proceeding that arises under the Bankruptcy Code (Title 11, U.S.C.), is within the jurisdiction of the district court pursuant to 28 U.S.C. § 1334(b). The district court may refer such proceedings to bankruptcy judges pursuant to 28 U.S.C. 157(a), and by General Rule 2.33, the District Court for the Northern District of Illinois has done so. The confirmation of a plan, pursuant to 28 U.S.C. § 157(b)(2)(L),

is a core matter as to which a bankruptcy judge may enter appropriate orders and judgments.

Findings of Fact

Background. The debtor is an Illinois limited partnership that owns fifteen floors of office space in a building in the central business district of Chicago. These floors are the upper portion of a larger building, whose lower portion is devoted to retail stores and parking. The lower portion is separately owned, with the two owners jointly responsible for maintenance. The debtor's property is encumbered by a lien in favor of Bank of America Illinois (the bank). This lien secures a nonrecourse note in the principal amount of $92,582,000. The note became due and payable, according to its terms, on January 3, 1995. The debtor was unable to pay the note at that time, and the bank commenced a state court foreclosure action on January 20. In response, the debtor filed this bankruptcy case on March 13. At the time of the filing, the bank's claim, principal and interest, was $93,013,612. Also outstanding at the time of the filing were several other, smaller claims: (a) a state property tax claim of about $2.3 million, (b) general unsecured trade debt of about $160,000, (c) unsecured insider claims of $7.7 million (of which $6.8 million is a claim of the debtor's general partner for an unsecured loan), and (d) a second mortgage held by the debtor's general partner in the amount of $11.3 million. After the filing, the debtor's general partner purchased some of the trade claims, reducing the general unsecured claims held by noninsiders to about $90,000. In addition to its real property, the debtor holds the right to a cash account, consisting of prepetition rents, that at the time of confirmation held approximately $3.1 million.

Because of the relatively straightforward financial issues of this case, and in order to avoid motions raising the

question of whether an effective reorganization was possible, the court ordered the debtor to propose its plan of reorganization within 30 days of the case filing. Accordingly, on April 13, the debtor proposed its original plan of reorganization, subsequently amended on May 12. To expedite the proceedings further, the court conditionally approved a disclosure statement for the May 12 plan, and, with the consent of the parties, considered the adequacy of the statement, together with plan confirmation, at a single hearing. See A. Thomas Small, "Small Business Chapter 11 and Chapter 11A Cases," Education Program Materials, 67th Annual Meeting of the National Conference of Bankruptcy Judges, Orlando, Florida, Oct. 17-20, 1993, p. 1-23, for a description of this procedure. The court held a hearing and received briefs from the parties in June, and, on August 7, denied confirmation of the plan. The principal ground for the ruling was unfeasibility: the minimum interest rate that the court found to be required for payment of the bank's secured claim could not be supported by the projected cash flow of the property. However, because the question of the appropriate interest rate was an unsettled legal issue, the court allowed the debtor an opportunity to amend its plan.

After a number of revisions, the debtor ultimately proposed the pending plan, dated September 11, and the court again conditionally approved a disclosure statement for the plan. On October 20, following notice and an opportunity for creditors to change their votes, the court conducted a second combined hearing on adequacy of disclosure and confirmation. At this hearing, there was no objection to the adequacy of the disclosure statement, and it was agreed that evidence taken in the first confirmation hearing would be considered in connection with the September 11 plan.

Property valuation. The principal factual dispute between the parties concerns the value of the property, and

the closely related question of the cash flow the property is likely to generate. Both the debtor and the bank presented expert appraisal testimony on these issues, and the experts agreed on the most appropriate valuation method: discounted cash flow. This technique—described in Leslie K. Beckhart, *No Intrinsic Value: The Failure of Traditional Real Estate Investment Methods to Value Income-Producing Property*, 66 S.Cal.L.Rev. 2251, 2285-2288 (1993)—operates basically in three steps. First, the appraiser estimates the cash flow that the property will generate each year of a several year holding period. Next, the appraiser determines the "reversionary" value of the property, at the end of the period, by capitalizing a stabilized income that the property is estimated to then produce. Finally, using an appropriate discount rate, the appraiser reduces the values derived in the first two steps to present values, and totals these values to arrive at the value of the property. See American Institute of Real Estate Appraisers, *The Appraisal of Real Estate* 487-518 (9th ed. 1987), for a fuller discussion of this method of valuation.

The court accepts the discounted cash flow method of valuation. The Beckhart article persuasively argues for its superiority over alternative methods, and the agreement of opposing experts gives a further indication of its appropriateness. To arrive at a valuation of the property, then, it is necessary (1) to estimate net cash flows over an appropriate holding period, and (2) to determine both an appropriate capitalization rate for the reversion and an appropriate discount rate.

In the pending case, each of the appraisers chose a period of ten years for estimating annual cash flow, and then capitalized a stabilized income for the eleventh year. The appraisers differed, however, in their estimates of income and in the capitalization and discount rates they applied. The debtor's appraiser applied a higher discount rate (14.367%)

to overall higher income estimat s; the bank's appraiser used both a lower discount rate (11.75%) and lower income estimates.[1] The following table summarizes the differences in their determinations for the ten year holding period, with the debtor's valuation about $1.1 million higher than the bank's.

[1] The debtor's appraiser used a 13.5% discount rate, compounded monthly, for purposes of discounting the annual cash flows. This rate is equivalent to an APR of 14.367%, which is used here to make the comparisons consistent (all other discount figures use annual compounding).

Year Ending	Debtor's Estimated Cash Flow (in $ thousands)	Present Value (discounted at 14.367%)	Bank's Estimated Cash Flow (in $ thousands)	Present Value (discounted at 11.75%)
1996	4,085	3,572	4,334	3,878
1997	5,720	4,373	5,769	4,620
1998	5,768	3,856	2,904	2,081
1999	5,683	3,322	5,587	3,583
2000	6,933	3,543	7,195	4,129
2001	7,388	3,302	7,751	3,980
2002	1,938	757	3,438	1,580
2003	4,350	1,486	(3,446)	(1,417)
2004	7,238	2,162	6,081	2,237
2005	8,637	2,256	8,464	2,787
Total	58,285	28,628	48,077	27,457

The appraisers similarly differed in their calculation of the reversionary value, as shown below, but here the debtor's valuation was about $4.8 million less than the bank's:

	Debtor	Bank
Estimated Stabilized Income (in $ thousands)	9,143	8,340
Capitalization Rate	.10	.09
Gross Reversionary Value	91,425	92,667
Estimated Disposition Cost	2,286 (2.5%)	1,853 (2%)
Net Reversionary Value	89,140	90,814
Discount Rate	.135	.1175
Present Value	25,125	29,900

The result of these differing approaches was an estimated value of $53,750,000 by the debtor and $57,400,000 by the bank.

The court cannot accept either of these valuations. The future cash flows of the property depend primarily on the renewal of leases. The property is, at present, nearly fully leased, but two leases to major tenants will expire during the ten-year holding period. The debtor negotiated a renewal of one of these leases contingent on confirmation of its plan, and that renewal is reflected in the appraisers' estimates of future cash flow. The other major tenant, however, has not agreed to a lease renewal. If it fails to renew, the debtor may experience (1) a period of vacancy in a significant portion of its space, (2) increased commissions on rerental, and (3) increased costs of space alteration. The bank's appraiser treated this tenant's lease, for most purposes, in the same way as other, smaller tenants, estimating a 50% chance of renewal. The debtor's appraisal, on the other hand, assumed

a 100% chance of renewal of the lease, and assumed highly favorable circumstances in that renewal. This is the primary basis for the difference in estimated cash flows. The court's assessment of the situation generally lies between those of the appraisers. Given the size of the space occupied by the tenant, and the paucity of available alternative space, it is very likely that the tenant will renew its lease. However, the importance of the tenant to the debtor's operations will likely allow it concessions that will depress the debtor's cash flows under the renewed lease. Thus, the most reasonable estimation of income reflects no extraordinary loss at the time of the lease expiration, but lower income than suggested by either appraiser in the period after the renewal of the lease.

The difference between the two appraisers on capitalization and discount rates reflects their different approaches to income estimation. The debtor's appraiser took the point of view that because the cash flow projections were somewhat risky, the capitalization and discount rate should be at the high end of the spectrum of reasonable rates. The bank's appraiser took the point of view, in light of the high quality of the building (and perhaps the conservative estimation of cash flows), that the rates should be at the lower end of the spectrum. The court's view is that, when the income is properly estimated to take into consideration the most likely leasing results, the rates employed should be those of an average building of the debtor's type: in this case, a first class office building in the central business district. From the data presented by the appraisers, these average rates would be a 10% terminal capitalization rate and a 12% discount rate.

Applying the 12% discount rate to future cash flows, as found by the court, results in a present value, over the ten-year holding period, of $30.0 million, as shown below:

Year Ending	Estimated Cash Flow (in $ thousands)	Present Value (discounted at 12%)
1996	4,100	3,661
1997	5,700	4,545
1998	5,300	3,772
1999	5,700	3,621
2000	6,900	3,916
2001	7,300	3,698
2002	1,000	452
2003	3,800	1,538
2004	6,500	2,344
2005	7,700	2,479
Total	54,000	30,026

The present value of the reversion, based on stabilized income in the eleventh year of $8.2 million, capitalized at 10%, and discounted at 12%, is $25.8 million, calculated as shown below:

Estimated Stabilized Income (in $ thousands)	8,200
Capitalization Rate	.10
Gross Reversionary Value	82,000
Estimated Disposition Cost	1,845 (2.25%)
Net Reversionary Value	80,155
Discount Rate	.12
Present Value	25,806

The total value of the property, then, as of the time of the confirmation hearing, was $55.8 million.

The debtor's plan. The major features of the debtor's September 11 plan, relevant to the present decision, are the following:

(1) The debtor's partners would contribute a total of $6.125 million in new capital to the debtor over the life of the plan, $3 million on the day after the effective date of the plan, and $625,000 on each of the next five anniversaries of the effective date. The payment of the five annual installments would be secured by a continuing letter of credit in the amount of $1,250,000.

(2) Priority and tax claims would be paid in full, within 30 days of the effective date of the plan, from funds currently on deposit.

(3) The trade creditors would be paid in full, without interest, 180 days after the effective date of the plan. Upon confirmation, the insiders would waive the general unsecured claims that they hold (including, apparently, the claims purchased by the general partner).

(4) The bank's secured claim, fixed at $54,544,500, would be paid partly in cash ($1,149,500 within five days of the effective date of the plan), and partly through an interest bearing note, secured by the bank's lien on the property. Monthly payments would be made on the note, on a thirty-year amortization schedule, and the note would mature in seven years, extendable to ten years at the debtor's option, upon certain conditions. The principal of the note would further be reduced by monthly payments to the bank of the excess cash flow of the property. The note would compensate the bank for its extension of credit in three ways; first, a commitment fee in an amount between $266,975 and $545,000, to be determined by the court; second, fixed "base interest" at a rate 3-1/2 per cent over the rate of U.S. Treasury obligations maturing 7 years after the effective date of the plan; and third, "participation interest" of 50% of the net value of the property, either as realized in a sale, or as appraised at the time of any refinancing.

(5) From the remaining value of the property at the time of sale or refinance, payments would be made in the following order: (a) on the unsecured deficiency claim of the bank, payment in full, without interest; (b) for the new capital contributions, payment in full, with interest at varying rates; (c) on the second mortgage held by the general partner, full payment with 10% simple interest; and (d) to the debtor's partners in proportion to their contributions of new capital.

(6) In the event of any default in making the new capital contributions or in making payments under the note, a deed to the debtor's property, held in escrow by a title company, is to be conveyed to the bank. The plan also has a number of features designed to minimize the possibility of any future bankruptcy filing interfering with the bank's right to obtain this conveyance.

This plan, and indeed, the entire bankruptcy case, was filed by the debtor primarily to avoid the severe tax

consequences to the debtor's partners of a foreclosure sale of the debtor's property. The principal of the general partner estimated the collective tax liability of the partners, in the event of foreclosure, at $20 million.

The general unsecured creditors in the class defined by the debtor's plan voted in favor of the plan; the only votes against confirmation were those of claims held or purchased by the bank.

Conclusions of Law

In order for a plan to be confirmed in a Chapter 11 case, the proponent of the plan must demonstrate that the requirements of Section 1129 of the Bankruptcy Code are satisfied. Although the matter has been debated, it now appears fairly well established that the burden of proof is by a preponderance of the evidence. *In re Briscoe Enters., Ltd., II*, 994 F.2d 1160, 1163-65 (5th Cir. 1993); *In re Arnold & Baker Farms*, 177 B.R. 648, 654-55 (Bankr.9th Cir. 1994); *In re Locke Mill Partners*, 178 B.R. 697, 700 (Bankr.M.D.N.C. 1995). That standard has been applied to the fact findings set forth above, and in the discussion that follows. However, even if a plan proponent were required to establish compliance with Section 1129 by clear and convincing evidence, the court's determinations would be the same.

Section 1129 operates in two parts. First, Section 1129(a) sets forth a number of requirements generally applicable to Chapter 11 plans. These include, in Section 1129(a)(8), a requirement that the plan be accepted by each impaired class of claims or interests. Second, Section 1129(b) provides that a plan complying with all of the other requirements of Section 1129(a) may be confirmed despite the failure of an impaired class to accept it, if several additional "cram down" requirements are also met. *In re Bryson Properties, XVIII*, 961 F.2d 496, 500 (4th Cir. 1992); *Hanson*

v. First Bank, 828 F.2d 1310, 1312 n.2 (8th Cir. 1987). Because the bank has not accepted the debtor's plan, both the general and cram down requirements are applicable here. The bank contends that the plan fails to meet nine of these requirements.

In considering the bank's objections, it is helpful to group them into three general categories: treatment of the secured claim, treatment of unsecured claims, and general requirements for confirmation.

A. Treatment of the bank's secured claim.

Objection 1: Section 1129(b)(2)(A).

The cram down provisions of Section 1129(b)(1) include the requirement that a plan be "fair and equitable" with respect to each nonaccepting impaired class. Section 1129(b)(2) fleshes out this requirement by defining minimum standards of fairness and equity in the treatment of the various classes of claims and interests. The minimum standards for secured claims are set out in Section 1129(b)(2)(A). Under this provision, a plan may provide for the creditor to retain the liens on its collateral and for creditor to "receive on account of [its secured] claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in [the collateral]." Under this option, the creditor must be paid the amount of its allowed secured claim together with a market rate of interest. *In re Bryson Properties, XVIII*, 961 F.2d 496, 500-01 (4th Cir. 1992) (market rate of interest provides creditor with present value of its claim); *cf. In re James Wilson Assocs.*, 965 F.2d 160, 172 (7th Cir. 1992) (indubitable equivalent of claim is provided by an interest rate that "compensates [the secured creditor] for the opportunity cost of its money and the risk of default"). The bank contends that the September 11 plan fails to meet this

requirement in two respects: first, that it undervalues the bank's claim; second, that the interest rate is below market.

Disposition costs. With respect to the amount of the secured claim, the parties agree that because the collateral supporting the bank's claim is worth less than the bank's total claim ($93,013,612), and because the bank did not make the election under Section 1111(b) of the Code to have its total claim treated as secured, there must be a bifurcation of that claim under Section 506(a). This bifurcation results in the bank having a secured claim to the extent of the value of its interest in the collateral, and an unsecured claim for the difference between the value of its interest in the collateral and its total claim. The parties further agree that, for purposes of this bifurcation, the collateral should be valued as of the time of confirmation. See *In re Addison Properties Ltd. Partnership*, 185 B.R. 766, 770-75 (Bankr.N.D.Ill. 1995), for a discussion of the process and timing of Section 506(a) bifurcation. As set out above, the court has valued the debtor's property serving as collateral for the bank's claim at $55,800,000. The disagreement between the parties—beyond the factual issue of the valuation—is over the question of whether the bank's interest in the property should be reduced by the costs that the bank would incur in converting that interest to cash. The debtor's plan estimates the bank's disposition costs at 2-1/4% of the property value ($1,255,500), and so sets the amount of the secured claim at $54,544,500. The bank raised no objection to the amount of the estimated costs, and the court finds them reasonable. However, the bank argues that it is improper as matter of law for any disposition costs to be used in valuing its interest in the debtor's property, citing, among other decisions, *In re Winthrop Old Farm Nurseries, Inc.*, 50 F.3d 72, 74 (1st Cir. 1995); *In re Trimble*, 50 F.3d 530, 532 (8th Cir. 1995); and *In re Rash*, 31 F.3d 325, 329 (5th Cir. 1994), *modified*, 62 F.3d 685, *reh'g en banc granted*, 68 F.3d 113 (1995).

The decisions cited by the bank primarily deal with the question of whether, for purposes of bifurcation under Section 506(a), the value of collateral should be viewed from the perspective of the debtor or the creditor. The relevant statutory language is the following:

> [1] An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. [2] Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . . .

Initially, courts construed this language by placing primary emphasis on the first sentence of Section 506(a), which defines the secured claim as the value of the "creditor's interest" in the estate's interest in property. Because the creditor would ordinarily be able to obtain the value of its interest only in a wholesale transaction or foreclosure sale, the courts generally sought to determine what value that the creditor would obtain in such a sale. The disposition costs involved in such a sale, accordingly, were deducted. *See In re Balbus*, 933 F.2d 246, 252-53 (4th Cir. 1991) (Murnaghan, J., dissenting) (collecting authorities). Later decisions, including those cited by the bank, focused more on the second sentence of Section 506(a), which requires that the value of the secured claim be determined in light of "the proposed disposition or use" of the collateral. This language suggested to these courts that valuation should depend on what the debtor plans to do with the property, and that, unless the debtor plans a liquidation, the property should be valued at its retail or replacement cost. Under this view, the

creditor's likely disposition costs are irrelevant to the determination. *See In re Rash*, 62 F.3d at 685-87 (collecting authorities).

However, despite its adoption by a number of circuits, this "second sentence" view of Section 506(a) is not the best reading of the section. In order to give effect to all of the statutory language, the value of the secured claim should be measured—as first sentence of Section 506(a) requires—by the value of the "creditor's interest" in the estate's property, and unless the creditor has some special capacity for dealing with that property, its interest is the value that it can obtain from a sale of the property. Indeed, the Code gives the debtor the alternative of treating secured claims in cram down by selling the property and giving the creditor a claim to the net proceeds. 11 U.S.C. §§ 1129(b)(2)(A)(ii), 506(c). Next—as the second sentence of Section 506(a) states—the disposition and use of the property must be seen as having a potential influence on the value of the creditor's interest. Thus, if a debtor intends to hold damaged equipment for ultimate sale as scrap, the creditor cannot assert that it should be valued as though it were repaired and used in a going concern. And similarly, if the property is intended to be used in an ongoing business, the debtor cannot insist on a forced-sale valuation. In this way, the intended disposition or use of the property is relevant, but, as Judge Robert Parker pointed out in his dissent from denial of panel rehearing in *Rash*, now pending rehearing en banc, intended disposition or use is relevant only "to the extent that it affects the creditor's interest in the collateral." 62 F.3d at 688.

Here, the creditor is a bank, and there is no indication that, in the absence of a bankruptcy, the bank would operate the property as owner. Its interest, as creditor, is in reducing its claim against the property to cash. Taking into consideration the use of the property intended by the debtor, there is no reason to suppose that the bank would not be able

to sell the property for its fair market value, and so the bank is entitled to this value, rather than a lower value based on a foreclosure or other forced sale. However, in order to realize fair market value, the bank would have to incur disposition costs, and those costs are properly deducted in determining the value of the bank's interest in the property and, hence, the amount of its secured claim under Section 506(a). *Cf. In re Schaumburg Hotel Owner Ltd. Partnership*, 97 B.R. 943, 948-49 (Bankr.N.D.Ill. 1989), and *In re Davis*, 14 B.R. 226, 228 (Bankr.D.Me. 1981) (each valuing a claim secured by property retained by the debtor at fair market price less disposition costs).[2] The valuation of the bank's secured claim at $54,544,500 is therefore correct.

Interest. With the amount of the bank's secured claim fixed, the remaining issue under Section 1129(b)(2)(A) is the

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[2] *Winthrop Old Farm Nurseries* expresses the fear that this interpretation of Section 506(a) will lead to inequitable results: "allow[ing] a reorganizing debtor to reap a windfall by stripping down the lien to liquidation value and quickly selling the collateral at fair market value, thus pocketing equity that would have been completely beyond reach save for the filing of the bankruptcy petition." 50 F.3d at 76. This fear is misplaced for two reasons. First, the property should be valued using whatever method of sale, commercially available to the creditor, produces the highest value. In many cases, like the present one, this will be the fair market value. A debtor, no less than its secured creditor, would incur disposition costs to obtain this value, and so there is no "quick profit" available to the debtor. Second, to the extent that the debtor is able to sell the property for more than the value of the secured claim, the resulting profit may well be directed—as in the present case—to the payment of unsecured claims, including the secured creditor's deficiency claim, rather than to the pockets of the debtor.

(continued...)

market rate of interest that properly compensates the bank for not receiving a cash payment of this claim on the effective date of the plan. In assessing this rate, a key role is played by the discount rate used to establish the fair market value of the property.

a. The minimum interest for a nonrecourse loan with a 100% loan to value ratio is the discount rate. As the bank's expert persuasively testified, it is economically impossible for a lender to make a nonrecourse loan secured only by real property that is worth no more than the amount of the loan (*i.e.*, a nonrecourse loan with a 100% loan to value ratio). The reason for this is clear from a comparison of the discount rate with an appropriate interest rate.

The discount rate, as described above, determines the price that an owner is willing to pay to receive the expected future cash flows of a particular investment. The owner discounts the future returns on the investment by a rate that reflects two different costs: (1) the cost of not consuming its cash immediately, together with the cost of inflation—what the *James Wilson* decision refers to as "the opportunity cost of its money," and (2) a risk premium, reflecting the uncertainty that the expected returns will actually be realized. Beckhart, *No Intrinsic Value, supra*, 66 So.Cal.L.Rev. at 2286; *cf.* Frank K. Reilly, *Investment Analysis and Portfolio Management* 17-25 (4th ed. 1994) (discussing components of

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[2] (...continued)

Other decisions, *e.g.*, *In re McClurkin*, 31 F.3d 401, 405 (6th Cir. 1994), use the phrase "purely hypothetical" in determining that disposition costs should not be deducted from the value of a secured creditor's claim. Yet the entire process of claim valuation is "purely hypothetical," since it ascribes value to property without an actual sale.

rate of return). The lender's interest rate similarly compensates the lender for its "opportunity cost" and risk premium. "Opportunity costs" are the same for both an owner and a lender. Reilly, *supra,* at 21 (costs related to deferred use of money and inflation affect all investments equally). So if the risk premium for a particular investment is also same for both owner and lender, the owner's discount rate and the lender's interest rate would be identical.

This situation can easily be imagined: consider a nonrecourse loan made to finance the purchase of Treasury bills, with the bills themselves the only security for the loan, and the term of the loan equal to the bills' term to maturity. Since T-bills are assumed to be risk free, Reilly, *supra*, at 19, the risk premium for the owner of the bills and for the lender is identical—zero for each. Ignoring the transaction costs of processing and enforcing the loan, the only costs to the owner and the lender in such a transaction would be the identical "opportunity cost," and so the discount rate that the buyer would use in determining what to pay for the bills would be the same as the interest rate that the lender would demand on a loan for the purchase price. With the interest rate equal to the discount rate, the owner would pay in interest all of the anticipated earnings on the bond, and this is entirely reasonable: the owner, having put nothing at risk, would hardly be accorded any earnings; the lender, having risked the entire sum necessary to purchase the bonds, would expect all of the earnings.

If the situation is changed to one in which the risk to the lender is greater than the risk to the owner, then the interest rate must be higher than the discount rate. This is precisely the situation in regard to a nonrecourse loan for the entire value of real estate, secured only by the real estate. Even if transaction costs are again ignored, the lender has greater risk, since its return is limited to the interest specified in its agreement with the owner, while the owner has the benefit of

any greater than anticipated cash flows. *Cf. Dacon Bolingbrook Assocs. v. Fed. Nat'l Mortgage Ass'n,* 155 B.R. 467, 470 n.12 (N.D.Ill. 1993) (noting that second mortgage holder has greater risk than owner of equity). Accordingly, a market-based, nonrecourse loan for the entire value of real property is the economic equivalent of a flying pig: it does not and cannot exist. To compensate the lender properly for the increased risk it bears, the interest rate on such a loan would have to be higher than the discount rate used by the owner in valuing the property, and this would require a return to the lender of more than the anticipated cash flow of the property. In this way, financial theory corroborates common sense: even more than in the situation of T-bills, an owner who invests no money in the purchase of real property, and assumes no liability, will not, in the market, receive any return on its "investment."

This situation would not change simply because two lenders were involved instead of one. The debtor's expert testified, without contradiction, that a commercial lender would be willing to make a ten-year nonrecourse first mortgage loan of 70% of the value of the debtor's property with a risk premium rate of 2% over the rate of Treasury issues with a comparable maturity (then about 6%), for a total interest rate of 8%. It is reasonable that such a loan would bear an interest rate less than the discount rate, because the risk that the lender will not receive its expected earnings is substantially reduced by the 30% equity cushion. However, any second-mortgage lender in such a situation would require a rate of interest on a loan of the remaining 30% of the property value much greater than the discount rate, and the blended interest rate on the two loans would exceed the discount rate.

For an illustration of this process, consider the situation suggested by the debtor's expert: a nonrecourse first mortgage loan of 70% of the value of real property, at 8% interest,

where the property is valued using a 12% discount rate. For purposes of illustration, assume that the property is worth $1000; the loan would then be $700, and the owner's investment would be $300. If the property performs as expected, 12% of its value annually (on average), or $120 will be generated in net cash flow. Of this cash flow, 8% of the $700 loan—$56—would annually be expended in interest on the loan. The owner would then receive the remaining cash flow—$64—as a return on its investment of $300. That is an annual return to the owner of 21.3% ($64/300). The owner receives this return, higher than the discount rate, because its risk is leveraged: the first mortgage lender receives nearly half of the income of the property before the owner receives anything. A second lender who took the debtor's position in this situation would similarly have leveraged risk, but its risk would again be greater than the owner's, because of its inability to obtain greater than anticipated cash flows. Thus, the lender would require, for a market rate of interest, more than the owner's leveraged anticipated rate of return, or, in this illustration, more than 21.3%.

There are decisions that attempt to arrive at a hypothetical market rate for cram down of the undersecured portion of a secured claim by similarly splitting the claim into two separate portions: a 70-75% portion that can be financed at a commercial rate, and a 25-30% portion that is financed at a hypothetical "second-mortgage" or "equity" lending rate. The rates attributable to the two loans are then blended. See the "band of investment" technique employed in *In re Bloomingdale Partners*, 155 B.R. 961, 984-85 (Bankr.N.D.Ill. 1993), and *In re SM 104 Ltd.*, 160 B.R. 202, 233-34 (Bankr.S.D.Fla. 1993). If the second-mortgage loan in the band of investment technique is accorded a properly leveraged interest rate, this technique will similarly result in the conclusion that a nonrecourse loan for 100% of the value

of real property is not possible, because the blended interest rate will be greater than the discount rate.

It was largely on this basis that the court denied confirmation of the debtor's initial plan. The proposed interest rate was below the discount rate, and payment of interest at greater than the discount rate would be impossible, requiring expenditure of more than all of the property's anticipated cash flow.

b. The debtor's present plan provides for payment of a market rate of interest. From the foregoing discussion of discount and interest rate, it is apparent that, for cram down of an undersecured claim in a single asset real estate case, the secured creditor must be given something of value to reduce the risk that it faces in extending financing of 100% of the value of its secured claim, without recourse. The debtor's September 11 plan, now before the court, reduces the risk to the secured creditor of payment on its secured claim in several respects, as compared to simple nonrecourse financing of the entire property value.

- The debtor would use newly contributed funds, now on deposit, to make an immediate cash payment of $1,149,500 on the secured claim. Thus, the proposed new note to the bank would be in the principal amount of $53,395,000, about 98% of the value of the bank's interest in the property.

- The debtor proposes to use additional funds now on deposit ($1,850,500), and five future annual contributions of $625,000 to add to the debtor's operating funds. The first two of these payments (totaling $1,250,000) are secured by a letter of credit; discounting these two payments at 8% (considering the reduced risk involved with the letter of credit) produces a present value of $1,114,500. These additional funds reduce the risk to the bank that any shortage in anticipated cash flows will result in the debtor's inability

to repay the loan. Moreover, the notes documenting the partners' obligation to make their annual contributions are collateral for the new note to the bank. If the present value of all of the money to be contributed by the partners, either now on deposit or secured by the letter of credit, $4,114,500, is counted as "value" to the bank, the loan to value ratio for the proposed new note drops to about 93%.

• Although the new bank note is nonrecourse, the partners are liable to the extent of their promissory notes for annual contributions, and apart from these notes, there is "de facto" recourse. As noted above, the partners will suffer a collective $20 million dollar tax liability if the debtor's property is sold in a foreclosure sale. They have a substantial incentive, therefore, to make their additional contributions to the partnership to assure that the partnership meets its obligations under the new note to the bank. Moreover, the letter of credit securing payment of the partners' contributions is not fully released until all five of the $625,000 annual payments are made. These factors combine to give some assurance that even the three payments not initially secured by the letter of credit will be made. It is difficult to value these last contributions for collateral purposes, since payment would depend on the future financial situation of the individual partners, a question not fully explored at the hearing. However, even if the last three payments are discounted at 18%, indicating a quite high risk of nonpayment, they would still provide present value of about $976,000, reducing the loan to value ratio for the proposed new note to about 91%.

The compensation offered to the bank under the proposed new note is not a flat interest rate. Rather, as described above, it consists of three separate elements: a loan origination fee of between $266,975 and $545,000, fixed base interest (at 3.5% over the rate earned by Treasury obligations maturing 7 years from the effective date of the plan), and a

50% participation in the net proceeds of any sale or refinancing. Using the cash flow projections set forth in the findings of fact, assuming that the debtor's partners make all of the contributions provided for by the plan, and fixing the origination fee at $266,975, these provisions would allow the bank a total ("all-in") rate of return of about 12% on its secured claim. The debtor can propose this compensation to the bank, at a rate that approximates the discount rate used to value the property, for two reasons: first, there is the contribution of new capital, which allows the amount financed to be less than the value of the property; second, a portion of the compensation is not paid until sale or refinance, and it is based on an anticipated appreciation of the property. Whether this is a market rate of return (*i.e.*, a rate that adequately compensates the bank for its "opportunity cost" and the risk of nonpayment), depends on how, in the market, a lender would view the entire transaction proposed by the debtor.

The debtor presented convincing evidence that the transaction is acceptable in the market. Robert Walter, a regional vice president of General Electric Capital Corporation ("GE Capital"), prepared a letter of intent, outlining the terms on which GE Capital would consider financing the debtor's property. In all but one respect, discussed below, the terms of the letter of intent are the same, or more favorable to the debtor, than the terms of the new note proposed by the September 11 plan. The most significant difference between the letter of intent and the proposed new note is that the letter of intent, unlike the note, reduces the net proceeds subject to lender participation by the amount of new capital contributed, and allows the partners a 9% equity return on their new capital before net cash flows are paid to reduce the loan principal. As a result of these differences, among others, the all-in rate of return under the letter of intent is significantly less than under the plan:

10.64% as calculated by the bank's expert; 11.28%, as calculated by the debtor.[3]

The debtor did not pursue a commitment from GE Capital because the bank indicated that it would not agree to a cash payment of its secured claim in the amount found by the court, and the bank would have had the option of having its entire claim treated as secured if the debtor proposed such a cash out, pursuant to Section 1111(b) of the Code. However, Walter testified credibly that he had studied the financial data relevant to the debtor's property, that his letter of intent reflected terms that were consistent with the terms under which GE Capital made loans on central business district office buildings, and that the all-in rate of return under the terms of the letter of intent would adequately compensate GE Capital. Furthermore, he identified a number of other lenders who he believed would be interested in financing the debtor on similar terms.

The bank attempted to discredit Walter's testimony by characterizing GE Capital as an insignificant market participant. However, as a lender to single asset real estate projects in an annual amount of approximately $2 billion, GE Capital is significant, and has expertise bearing precisely on the issues relevant to a market rate of return on the note proposed by the September 11 plan. As further grounds for disregarding Walter's testimony, the bank's expert referred to a number of funds investing in distressed mortgages, which required returns in the range of 15-25%. Yet it is plain from the analysis set out above that these rates of return must be on properties whose cash flow is subject to much greater risk

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[3] The Debtor's Supplemental Post-Trial Memorandum, filed November 3, 1995, points out (at 8-10) errors in the bank's expert's calculations that account for the difference in the calculations.

than those of the debtor's property—*i.e.*, properties valued with discount rates much greater than the 12% applicable here. A property generating cash flow at an average of 12% simply cannot support financing at rates of 15-25%.

Accepting the testimony of Robert Walter, the court finds that the compensation to the bank proposed by the September 11 plan provides a market rate of return on the bank's secured claim, and that the treatment of the claim satisfies the requirements of Section 1129(b)(2)(A).[4]

B. Treatment of the bank's unsecured claims.

In addition to its secured claim, discussed above, the bank has unsecured claims in two classes defined by the September 11 plan. First, the bank has an unsecured deficiency claim of $38,469,112, the difference between its total mortgage claim, and the value of its interest in the

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[4] The one respect in which the debtor's plan is more favorable to the debtor than are the terms of the letter of intent is in the commitment fee. The letter of intent calls for a flat 1% fee of the loan amount, *i.e.*, $533,950. The debtor's plan calls for a commitment fee of $266,975, or such greater amount as the court may determine, up to $545,000 (1% of the total value of the bank's secured claim). The reason given by the debtor for paying the bank a smaller commitment fee than that required by the letter of intent is that GE Capital would need to engage in extensive due diligence in the course of committing to make the loan, while the bank, given its position as a present lender to the property and its involvement in the pending bankruptcy, would not need to incur such expenses in connection with the plan. This observation appears well founded. Moreover, as noted above, even with the reduced commitment fee, the plan provides a substantially greater return to the bank than the terms of the letter of intent would provide to GE Capital. Accordingly, the court will not set a commitment fee higher than $266,975.

debtor's property, pursuant to Section 506(a) of the Code. Second, the bank has purchased general trade claims worth about $5,000, and voted these claims against the debtor's plan. The bank has asserted objections to confirmation based on the proposed treatment of both of these classes of unsecured claims.

Objection 2: Section 1129(a)(7)(A)—the best interests test.

Section 1129(a)(7)(A) of the Code enunciates what was, under the former Bankruptcy Act, the "best interests of creditors" test. See 5 Collier on Bankruptcy ¶ 1129.02[7][a] (15th ed. 1995) for a discussion of the derivation of Section 1129(a)(7). The test provides that if a claim is impaired by a plan of reorganization, and if the holder of the claim has not accepted the plan, then the holder of the claim must receive on account of the claim "property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive . . . if the debtor were liquidated under chapter 7 . . . on such date." Both the bank's unsecured deficiency claim and its trade claims are impaired under the September 11 plan, as discussed later in this opinion, and the bank, as holder, has not accepted the plan. Therefore the plan must provide the bank with payments on its claims having a present value, as of the effective date of the plan, at least equal to the amount that the bank would receive on its claims if the debtor were liquidated in a Chapter 7 case on the plan's effective date.

There is no question that the plan's treatment of the bank's unsecured deficiency claim meets this test. In a Chapter 7 liquidation, the bank would receive nothing on account of this claim. The bank's note is nonrecourse, requiring it to look only to its collateral for payment. Thus, any claim for the deficiency, in Chapter 7, would be disallowed as unenforceable under applicable nonbankruptcy law, pursuant to Section 502(b)(1). The deficiency is an

allowed claim in Chapter 11 only by operation of Section 1111(b)(1)(A). *In re Woodbrook Assocs.*, 19 F.3d 312, 318 (7th Cir. 1994). No payment of the deficiency claim, then, is necessary to meet the best interests test.

The situation is different with respect to the trade debt. The bank contends that these claims would be paid in full, with interest, in a Chapter 7 liquidation, and thus that the treatment of these claims under the plan—payment in full without interest, 180 days after the effective date of the plan—violates the best interests test. In response, the debtor argues that, in a Chapter 7 liquidation, there would only be payment of the principal amount of the claims, and that it would take at least 180 days for that payment to be made. Each of these arguments fails to apply Section 1129(a)(7) properly to the facts of this case.

First, the bank is mistaken in asserting that interest would be paid on trade debt in a Chapter 7 liquidation of the debtor. The debtor here has only two significant tangible assets: its real property, and a $3.1 million cash account. If the debtor were liquidated in a Chapter 7 case, the following events would transpire:

(1) The trustee would abandon the real property pursuant to Section 554 because it is fully encumbered, and its operation would be burdensome. In no event would the estate realize any value from the real estate.

(2) The $3.1 million cash account would be subject to distribution in payment of unsecured claims, pursuant to Section 726(a) of the Code, but it would be insufficient to pay these claims in full. The general unsecured claims against the estate include not only $160,000 in trade debt, but also $7.7 million in unsecured loans from insiders. Under Section 726, unsecured claims are not subject to different treatment simply because they are held by insiders. *Cf. In re Martin's Point Ltd. Partnership*, 12 B.R. 721, 727 (Bankr.N.D.Ga. 1981)

(allowing insider claims to be classified with other unsecured claims and noting that claims of equity holders are generally treated equally with those of other creditors); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990) (applying the rule of *Martin's Point* to prohibit separate classification of insider claims); 805 ILCS 210/804(l) (the Illinois enactment of Section 804 of the Revised Uniform Limited Partnership Act, under which claims of partners who are creditors of the partnership are treated equally with the claims of other creditors). Moreover, though the bank has questioned the assertion of the insider loans, it has not filed any objection to these claims, and they are deemed allowed, pursuant to Sections 1111(a) and 502(a). Accordingly, there is no reason to conclude that a Chapter 7 trustee would not treat the $7.7 million insider debt together with the $160,000 trade debt as claims to be paid under Section 726.

(3) Because the assets of the estate would be insufficient to pay the unsecured claims in full, a Chapter 7 trustee would pursue the assets of the general partner to the extent of the deficiency, pursuant to Section 723(a) of the Code. However, the Code distinguishes between the payment of claims and the payment of interest on claims. *Compare* 11 U.S.C. § 726(a)(l)-(4) (providing for "payment of claims") *with* 11 U.S.C. § 726(a)(5) (providing for "payment of interest . . . on any claim paid under paragraph (1), (2), (3), or (4) of this subsection"). Section 723(a) affords the trustee a claim against the general partner only to the extent necessary to pay the claims, not to the extent necessary to pay interest on claims. Of the $7.7 million in insider claims, the general partner's claim is $6.8 million. Of this amount, the trustee would likely be able to offset a sufficient amount to allow payment in full of the principal amount of other unsecured claims.

(4) The estate would then be closed with payment in full of all claims but that of the general partner, and partial payment to the general partner.

(5) Because all claims against the estate would not be paid in full, there would be no payment of interest on any unsecured claim, since payment of interest is made under Section 726(a)(5) only after payment of all allowed unsecured claims. The bank's assertion to the contrary is incorrect.

The debtor's mistake in the application of Section 1129(a)(7) is in asserting that payment of liquidation value may be delayed until the payment would likely be made in a Chapter 7 case. To the contrary, Section 1129(a)(7) directs that value be determined as if the debtor were "liquidated" on the effective date of the plan. Although "liquidate" is not defined in the Code, its ordinary meaning, in a financial context, is "[t]o pay off or settle (a debt, claim or obligation)" or "[t]o settle the affairs of (a business firm, for example) by determining the liabilities and applying the assets to their discharge," or, at the very least, "[t]o convert (assets) into cash." The American Heritage Dictionary 735 (2d College ed. 1982). The effect, then, of specifying that a liquidation value be assessed as of the effective date of the plan is to make certain that the creditors be given, as of that date, the value that they would have at the conclusion of the Chapter 7 process. And so, by delaying payment in full of the trade creditors claims for 180 days, the debtor's plan does violate the best interests test.

However, this is not a particularly significant violation. It appears that the debtor has ample cash available to pay all of the trade debt on the effective date of the plan. If the debtor nevertheless wishes to delay payment until after the effective date (perhaps to consider claim objections), it would have to pay interest to the trade creditors for the period of the delay. But since there is no substantial risk that the payment will not be made (the debtor having cash on deposit well in

excess of the amount owed, and the delay in payment being brief), interest at a comparable Treasury rate would be sufficient. The interest required for a 180 day delay in paying the $90,000 in trade debt not held by insiders of the debtor would be no more than $3000. The court will therefore allow confirmation of the September 11 plan, over the bank's "best interests" objection, but only if the debtor modifies the plan, pursuant to Section 1127(a), so as to comply with Section 1129(a)(7). *Cf. Travelers Ins. Co. v. KCC-Leawood Corporate Manor I*, 908 F.2d 343 (8th Cir. 1990) (dismissing appeal from conditional confirmation order).

Objection 3: Section 1129(b)(1)—unfair discrimination.

The best interests test applies to individual creditors holding impaired claims, even if the class as a whole votes to accept the plan. The bank's next objection—that the plan unfairly discriminates—is different. The prohibition against unfair discrimination applies only when a debtor seeks to confirm a plan despite the failure of an entire class to accept the plan. Section 1129(b)(1) provides that the plan may be confirmed against the nonaccepting impaired class (*i.e.*, "crammed down"), only if "the plan does not discriminate unfairly . . . with respect to each class of claims . . . that is impaired under, and has not accepted, the plan." As required by *In re Woodbrook Associates*, 19 F.3d 312, 319 (7th Cir. 1994), the debtor placed the deficiency claim of the bank in a class separate from the other general unsecured claims. The deficiency claim is impaired, and the bank did not accept the plan. Therefore, the deficiency claim may not be subject to unfair discrimination.

Unquestionably, the September 11 plan discriminates between the deficiency claim and the trade debt. As noted above, the trade debt is to be paid in full, shortly after confirmation; the deficiency claim is to be paid only upon

sale or refinancing of the property, and only from half the net proceeds (the other half going to pay participation interest on the bank's secured claim). If the sale or refinancing takes place in 10 years, at the value found by the court, the deficiency claim would be paid about $19 million, half of the claim. If this payment is discounted at the same 12% rate used to value the building, the dividend on the claim is only about 16%. The question is whether this discrimination (full payment of trade debt versus 16% payment of the unsecured deficiency) is unfair.

Answering this question is made difficult by the lack of any clear standard for determining the fairness of a discrimination in the treatment of classes under a Chapter 11 plan. Given the language of Section 1129(b)(1), some discrimination between classes of unsecured claims must be permissible. *In re Aztec Co.*, 107 B.R. 585, 588-89 (Bankr.M.D.Tenn. 1989) (rejecting decisions holding that "all unsecured claimholders must be paid the same percentage of claims" because "Section 1129(b)(1) prohibits only 'unfair' discrimination, not all discrimination."). However, the limits of fairness in this context have not been established. The debtor originally suggested that the court apply a four-part test that was developed in applying Section 1322(b)(1), a parallel prohibition of "unfair discrimination" for Chapter 13 plans. However, that test is unworkable, for the reasons set forth in *In re Brown*, 152 B.R. 232, 235-37 (Bankr.N.D.Ill.), *rev'd on other grounds, sub nom. McCullough v. Brown*, 162 B.R. 506 (N.D.Ill. 1993). At the same time, the alternative test applied in *Brown*, 152 B.R. at 237-39, was specifically grounded in the context and the legislative history of Chapter 13, and has no application to Chapter 11. The Seventh Circuit, in finding that the plan in *In re Woodbrook Associates*, 19 F.3d 312, 317-320 (7th Cir. 1994), involved unfair discrimination, stated only that the plan provided a 5% distribution to the unsecured deficiency claim of a mortgagee

while paying insiders of the debtor in full. The court did not discuss its general understanding of unfair discrimination.

Nevertheless, it is possible at least to lay a framework for measuring the fairness of a discrimination in Chapter 11 plans. First, any discrimination must be supported by a legally acceptable rationale. The result in *Woodbrook* can be seen as flowing from the failure of the debtor, as plan proponent, to give any rationale for discriminating against the mortgagee's deficiency claim and in favor of insiders. In contrast, the court in *In re Creekstone Apartments Associates, L.P.*, 168 B.R. 639, 644 (Bankr.M.D.Tenn. 1994), found that "[p]rotection of the debtor's creditor-worthiness with its vendors," as asserted by the debtor, was an acceptable rationale for discrimination in favor of trade creditors. Second, the extent of the discrimination must be necessary in light of the rationale. Again, the extreme disproportionality between the payments to insiders and to the deficiency claim of the mortgagee contributed to the finding of unfair discrimination in *Woodbrook,* and a similar disproportionality contributed to a finding of unfair discrimination in *In re Creekside Landing,* 140 B.R. 713, 716 (Bankr.M.D.Tenn. 1992).

Within this framework, the debtor's plan does not unfairly discriminate. First, the debtor has provided a compelling rationale for the discrimination in its treatment of unsecured claims: the best interests test. As discussed above, this test, set forth in Section 1129(a)(7) of the Code, requires that the debtor pay holders of impaired claims as much as they would have received in a Chapter 7 liquidation, and, in a Chapter 7 liquidation, the trade creditors in the present case would be paid in full. Thus, full payment of these claims under the debtor's plan was required for confirmation. On the other hand, the deficiency claim would be paid nothing in a Chapter 7 case, and so the best interests test does not mandate payment of this claim at any particular level. Since

the debtor does not now have sufficient funds to pay all of its creditors in full, and is unlikely to have sufficient funds during the course of its plan, some creditors—other than holders of trade debt—must be paid less than 100% of their claims.

Second, the discrimination in the debtor's plan is narrowly tailored to meet the requirements of the best interests test: the trade creditors are paid no more than the face amount of their claims, and all insider claims are either waived or subordinated to the bank's deficiency claim, allowing that claim to be paid in full before insiders of the debtor receive any payment under the plan. It is not clear that this degree of deference to the bank's deficiency claim would be required; valid insider claims may well have been paid on a par with the deficiency claim without unfair discrimination. However, the discrimination in the present plan, which, far from favoring insiders, subordinates them, cannot be seen as unfair to the deficiency claim.

Objection 4: Section 1129(b)(2)(B)—absolute priority and new value.

Just as Section 1129(b)(2)(A) sets forth minimum standards for applying the "fair and equitable" standard to secured claims in cram down, Section 1129(b)(2)(B) sets forth the minimum standards for "fair and equitable" treatment of unsecured claims. This minimum standard is the "absolute priority rule": unless each claim in a nonaccepting class of unsecured claims is paid in full (*i.e.*, given "property of a value, as of the effective date of the plan, equal to the allowed amount of such claim"), the plan must provide that "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B).

The bank argues that this provision is violated with respect to its deficiency claim. This claim, as noted above, will not be provided full payment under the debtor's plan. Nevertheless, holders of partnership interests in the debtor—which, as equity, are junior to the bank's claim—do receive property under the plan: retention of their ownership of the debtor, with the right to participate in the proceeds of any sale or refinancing of the property (albeit subordinated to the deficiency claim). The question is whether this retention of ownership is "on account of" the interests that the partners had at the outset of the case, or whether the retention of ownership is on account of the new capital contributions that the plan requires partners to make. A further question is whether, even if the new contributions are seen as the cause for the debtor's partners continuing to have partnership interests, the right to retain these interests in exchange for the new contributions is itself property that the partners receive on account of their prepetition interests.

These "new value" questions have been discussed in a large number of sharply divided opinions and commentary. The United States Supreme Court issued an opinion noting the question whether contributions of new value can ever support retention of ownership interests where creditors of the estate receive less than full payment, but expressly leaving the question open, and holding only that if new value can have this effect, it must be in the form of money or money's worth, rather than a promise to provide labor to the debtor. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 n.3 (1988). The Seventh Circuit likewise has raised the question several times, but declined to rule on it. One opinion of the court, *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1359-62 (7th Cir. 1990), presents a number of arguments against allowing retention of ownership through contribution of new value, but the opinion declines to reach the question, holding instead that the guarantees proposed to

be contributed by the debtor's owners would be insufficient in any event. Another decision of the court, *In re Snyder*, 967 F.2d 1126, 1128-31 (7th Cir. 1992), presents arguments in favor of allowing retention of ownership based on contribution of new value, but again declines to reach the question, holding that the bankruptcy court had not committed error in finding the $30,000 contribution proposed in that case to be insufficiently "substantial." Among decisions from other jurisdictions that actually do reach the issue, *In re A.V.B.I.*, 143 B.R. 738 (Bankr.C.D.Cal. 1992), thoroughly presents the arguments against allowing retention of ownership based on contribution of new value, and *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), thoroughly presents the contrary view.

This court is persuaded by the arguments advanced in *Bonner Mall* and *Snyder*, and will only summarize them here very briefly. The salient points are: (1) the language of Section 1129(b)(2)(B) cannot unambiguously be applied in the context of a contribution of new value by the debtor's owners; (2) given this genuine ambiguity, it is appropriate to look at pre-Code practice for aid in interpretation; (3) prior to the adoption of the Code, and particularly after *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 121 (1939), the availability of the "new value" approach to reorganization was generally recognized; (4) nothing in the legislative history of the Code, or the language of the Code itself, gives any clear indication that Congress intended to eliminate the new value approach. Accordingly, Section 1129(b)(2)(B) should be interpreted to allow retention of ownership interest "on account of" a contribution of new value, consistent with the requirements that the courts have imposed on this approach.

In *Snyder*, the court applied in effect a four-factor test for retention of ownership on account of a new value contribution. Citing *Los Angeles Lumber*, 308 U.S. at 121-

122, the court stated: "[A] qualifying new value contribution must be (1) necessary to the reorganization; (2) in the form of money or money's worth; and (3) reasonably equivalent to the interest retained." *Snyder*, 967 F.2d at 1131. The court added a fourth factor, that the contribution be "substantial," based on decisions rendered subsequent to *Los Angeles Lumber*. *Id.* Later, in *In re Woodbrook Associates*, 19 F.3d 312, 320 (7th Cir. 1994), the court commented further on the substantiality requirement, implying that substantiality serves as something of a summary of the other factors:

> Simply put, "substantiality" requires that the contribution be real and necessary to the successful implementation of a feasible plan. . . . A token cash infusion violates the absolute priority rule because the old equity owners are receiving the opportunity to purchase the new equity interest at a bargain price "on account of" their prepetition ownership.
>
> Whether the infusion of new capital is "substantial" is more a common sense determination than a mathematical calculation when the debtor comprises only a single real estate asset which is fully encumbered.

The three *Los Angeles Lumber* factors are satisfied by the new value proposed to be contributed under the debtor's September 11 plan. First, the contribution is necessary to the reorganization. The contribution was an essential ingredient in allowing a market rate of return to the bank's secured claim. Although the bank argues that the plan still will not succeed, the contribution is necessary for any attempt at reorganization. Second, the contribution is at least partly in the form of money or money's worth: cash and promissory notes secured by a letter of credit, with a present value of $4.1 million as of plan confirmation. The parties dispute whether the last three scheduled contributions should be

counted as "money's worth," but that dispute is not material here.[5] Third, the contribution is easily the equivalent of the interests retained by the debtor's partners. Indeed, on the market, those interests are worthless. Even after ten years of successful operation of the property under the September 11 plan, the entire proceeds of a sale or refinancing are projected to go to the bank. The debtor's partners thus seek to retain their interests not because of the intrinsic value of these interests, but because of the tax consequences that flow from their loss.

Rather than the three *Los Angeles Lumber* factors, it is the fourth new value factor—substantiality—that is principally in dispute here. The bank argues that the $4.1 million present value of the presently assured contributions should be compared to the total amount of unsecured debt, $58 million, making the contribution about 7% of the unsecured debt. The bank then points to decisions in which proposed new value contributions of between 2 and 6% of unsecured claims were found to be insubstantial. (In *Snyder*, the proposed contribution was 2.7% of total unsecured claims, 967 F.2d at 1131; in *Woodbrook*, the ratio was "at most" 3.8%, 19 F.3d at 320). The bank's argument is misguided in two respects. First, the total unsecured claims are not relevant here, since many of these claims belong to the general partner or an entity that it controls, and these insider claims have either been waived or subordinated to the bank. Similarly, the noninsider trade debt is paid in full under the plan. Thus, the only unsecured claim that is being involuntarily "primed" by the partners' retention of equity is the deficiency claim of the bank, in the amount of $38,469,112. The proposed new value contribution is about 10.7% of this amount. Second,

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[5] Similarly, it is not necessary to determine whether the waiver by the general partner of $6.9 million in general unsecured claims constitutes money's worth.

and more significantly, percentage comparisons of contribution value to unsecured claims are not dispositive. In *Snyder*, the Seventh Circuit cautioned that "there is no mathematical formula for resolving the substantiality issue, and it will depend on the circumstances of the individual case." 967 F.2d at 1131-32. And in both *Woodbrook* and *Snyder*, the court emphasized that the determination of substantiality "may not always hinge on a comparison of the proposed contribution to the total amount of unsecured debt." Here, the new value being contributed by the partners is substantial both in absolute terms and in its impact in this case. The $4.1 million minimum value of the contribution in this case dwarfs the $30,000 involved in *Snyder* and the $100,000 in *Woodbrook*. It constitutes over 20% of the tax liability the partners hope to avoid. And, most significantly, the total contribution package, however valued, is substantial enough to make possible a commercial loan on the debtor's property consistent with the terms of the proposed plan. That plan, in turn offers a substantial (16%) return on the bank's deficiency claim. The new value contributions proposed by the September 11 plan are not mere tokens, but genuine contributions to the proposed plan.

In all, the plan treats the unsecured claims held by the bank, both trade claims and the unsecured deficiency claim in a manner consistent with the requirements of Section 1129.

C. General requirements for confirmation.

In addition to specifying minimum standards for the treatment of claims, Section 1129 sets forth a number of general requirements for confirmation. The bank asserts that the debtor has failed to establish compliance with several of these general requirements.

Objection 5: Sections 1129(a)(1), 1123(b)(6), 365(c)(2)—forced relending.

At the outset of the hearing on confirmation of the September 11 plan, the plan contained a provision requiring the bank to relend to the debtor, at the debtor's request, any payments made by the debtor in excess of scheduled amortization, to the extent these funds were reasonably needed for alterations to the property, tenant improvements, and leasing commissions. The plan also had a provision for judicial resolution of disputes in the event the bank objected to any request by the debtor for such relending. After the bank objected to these provisions during the hearing, the debtor submitted a modified plan, omitting them. The plan, as currently proposed, specifies only (1) that the debtor may request relending, (2) that if the bank fails to respond within 10 business days after receipt of the request, the bank will be deemed to have agreed to it, and (3) that if the bank refuses the request, the bank must set forth its grounds for so doing. The plan now explicitly provides that the Bank has sole discretion regarding the granting of the request, and the procedure for court resolution of a dispute between the parties on this issue has been eliminated.

Nevertheless, the bank contends that the relending provisions violate Section 365(c)(2) of the Code, which provides that a trustee (and hence a debtor in possession, pursuant to Section 1107(a)) may not "assume or assign any executory contract . . . if . . . such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor." Of course, even as originally drafted, the September 11 plan did not purport to assume any existing loan agreement with the bank. It sought to create a new obligation on the part of the bank to extend a kind of revolving credit line. Hence, Section 365(c)(2) does not apply by its terms. Rather, the bank argues that the spirit of Section 365(c)(2) is to prevent

creditors from being required to lend money involuntarily to debtors. Then, because Section 1123(b)(6) only allows a plan to include provisions "not inconsistent with the applicable provisions" of the Code, the bank contends that the debtor has exceeded its authority under Section 1123. Ultimately, such an improper provision in a plan would violate Section 1129(a)(1), which requires that a plan comply with the applicable provisions of the Code.

It is not necessary here to analyze all the steps of the bank's argument, since the argument is flawed at its premise. The September 11 plan imposes no obligation on the bank to make any loan. The only obligation imposed is to make a reasonably prompt response to a loan request, with a specification of reasons for a denial. Clearly, the debtor still hopes to establish a revolving loan arrangement with the bank, and the plan sets up the mechanism for such an arrangement. However, in the event the bank chooses not to accept this arrangement, it is given sole discretion to reject it. In this way, the debtor's revised plan tracks the terms of the letter of intent with GE Capital. That letter, like the current plan, created the structure for a revolving loan arrangement based on excess amortization payments, but gave the lender sole discretion in extending financing under that structure.

Creating this structure is not inconsistent with the Bankruptcy Code. Under Section 1123(b)(6), a debtor is affirmatively authorized to include in a plan general provisions that are not inconsistent with other provisions of the Code. *See In re Trans World Airlines, Inc.*, 185 B.R. 302, 313 (Bankr. E.D.Mo. 1995) (confirming a plan containing numerous provisions pursuant to Section 1123(b)(6)). No provision of the Code is inconsistent with a plan requiring that the debtor's principal secured creditor respond with reasonable promptness and specificity to a request from the debtor for financing. Indeed, such a requirement is quite sensible: a prompt response from the

bank to a request by the debtor for financing from excess amortization will give the debtor the opportunity to correct any problems with its request if the bank is willing to consider the financing requested, or to make alternative arrangements if the bank will not consider the financing.

Objection 6: Section 1129(a)(3)—good faith.

Section 1129(a)(3) of the Code requires that any Chapter 11 plan be proposed in good faith. The bank argues that the debtor's motivation for filing its plan—avoidance of adverse tax consequences—in itself establishes that the plan was proposed in bad faith, particularly in the context of a single asset real estate case.

This argument is not consistent with governing law. First, the fact that this is a single asset real estate case does not render it a bad faith filing. The Bankruptcy Code contains no provision to this effect, and, to the contrary, was recently amended to deal specifically with certain single asset real estate cases. See 11 U.S.C. §§ 101(51B) (defining "single asset real estate") and 362(d)(3) (providing special grounds for relief from the automatic stay in single asset real estate cases), each added to the Code by Section 218 of the Bankruptcy Reform Act of 1994. *See also In re James Wilson Assocs.*, 965 F.2d 160 (7th Cir. 1992) (affirming confirmation of Chapter 11 plan in single asset real estate case). The Supreme Court itself has rejected the notion that Chapter 11 is limited to a particular type of business reorganization in holding that individuals are eligible for Chapter 11 relief. *Toibb v. Radloff*, 501 U.S. 157, 161 (1991).

Second, the bank's focus on the debtor's intent in filing the case is inappropriate. In *In re Madison Hotel Associates*, 749 F.2d 410, 425 (7th Cir. 1984), the court interpreted Section 1129(a)(3) as focusing on the content and effect of the

plan under consideration, not the subjective motivation of the plan proponent:

> [F]or purposes of determining good faith under section 1129(a)(3) . . . the important point of inquiry is the plan itself and whether such plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code.

Accord, In re Andreuccetti, 975 F.2d 413, 420 (7th Cir. 1992). The evidence presented at the confirmation hearing is consistent with this standard of good faith. The debtor has proposed a plan which sets forth an effort to pay noninsider claims (including the bank's deficiency claim) as much or more than they would receive in a liquidation. It delays any payment of insider claims until the sale or refinancing of the property, and then makes that payment subordinate to the bank's deficiency claim. It provides significant protection to the bank's secured claim. Its discrimination among unsecured claims, as discussed above, is reasonable. In proposing the terms of its plan, the debtor was admittedly motivated by fear of adverse tax consequences in the event a plan were not confirmed, but this has no effect on the operation of the plan.

Finally, even if the bank's challenge were considered as a request for relief based on bad faith in the debtor's *filing* of the case, an issue not particularly relevant to confirmation, the motivation of avoiding adverse tax consequences would still fail as evidence of bad faith. *In re Cadwell's Corners Partnership*, 174 B.R. 744, 762 (Bankr.N.D.Ill. 1994). Few bankruptcies, likely, are filed with altruistic intent; every debtor presumably files to obtain some benefit for itself or avoid some harm. *In re James Wilson Assocs.*, 965 F.2d 160, 170 (7th Cir. 1992) ("It is not bad faith to seek to gain an advantage from declaring bankruptcy—why else would one declare it?"). In its most general formulation, the standard for good faith in filing simply requires that, in pursuing its own interests, the debtor act with "fundamental fairness" and

"in a manner that complies with the spirit of the Bankruptcy Code's provisions." *In re Love*, 957 F.2d 1350, 1357 (7th Cir. 1992). Thus, unnecessary bankruptcies filed by debtors who can pay their creditors in the ordinary course, useless bankruptcies filed without prospect for reorganization, and harassing bankruptcies filed as part of a pattern of delay or misconduct, are found to be filed in bad faith. *In re N.R. Guaranteed Retirement, Inc.*, 112 B.R. 263 (Bankr.N.D.Ill.), *aff'd* 119 B.R. 149 (N.D.Ill. 1990) (discussing specific circumstances leading to findings of bad faith filing).

In the present case, none of these circumstances exist. At the time of the filing of this case, the debtor was genuinely in need of bankruptcy relief, with an expired mortgage and a pending foreclosure action. At the same time, given the quality and substantial cash flow of the debtor's property, there was a genuine prospect for reorganization, as reflected in this opinion. And there has been no pattern of delay here: the bankruptcy case was filed shortly after the mortgage became due, and it has proceeded expeditiously, with the debtor meeting all court-imposed deadlines.

Objection 7: Section 1129(a)(5)—quality of management.

Section 1129(a)(5) of the Code imposes, as a requirement for confirmation, (1) that there be disclosure of any individual proposed to serve, after confirmation, "as a director, officer, or voting trustee of the debtor," and (2) that the holding of office by each such individual "is consistent with the interests of creditors and equity security holders and with public policy." The bank asserts that this provision has not been complied with in the present case, because the debtor's management, prior to the bankruptcy filing and contrary to its agreement with the bank, made a deposit of rents that would otherwise have been used to pay real estate taxes into an account at another bank. The bank contends that the nonpayment of real estate taxes constitutes waste under

Illinois law, and that a willingness to engage in such nonpayment makes the continuation of current management contrary to the interests of creditors. The bank also asserts that changes in management personnel since the filing of this case further call into question the quality of the debtor's management. In support of its arguments, the bank cites *In re Rusty Jones, Inc.*, 110 B.R. 362, 375 (Bankr. N.D.Ill. 1990), and *In re SM 104 Ltd.*, 160 B.R. 202, 245 (Bankr.S.D.Fla. 1993).

The cited cases, however, presented factual situations very different from the present one. In each, the debtor's management had engaged in a pattern of conduct detrimental to creditors, including, in the *SM 104* case, deliberate violations of court orders and potentially fraudulent misrepresentations. Thus, *Rusty Jones* and *SM104* are consistent with the apparent intent of Section 1129(a)(5) to preclude continued service by prior management "if it directly or indirectly perpetuates incompetence, lack of discretion, inexperience, or affiliations with groups inimical to the best interests of the debtor." *In re Polytherm Indus., Inc.*, 33 B.R. 823, 829 (W.D.Wisc. 1983). Here, the bank points to a single transfer, which involved no conversion, but simply retained funds in the control of the debtor, and which was disclosed in the debtor's schedules. The transfer was an error in judgment—it exposed the debtor to tax penalties unnecessarily, and it was unlikely to achieve its intended purpose of advancing settlement discussions with the bank. However, the transfer is not indicative of a general course of conduct prejudicial to creditors. Moreover, the representative of the debtor who authorized the transfer testified without contradiction to extensive experience in managing commercial real estate successfully. *Cf. In re Landing Assocs., Ltd.*, 157 B.R. 791, 817 (Bankr.W.D.Tex. 1993) (confirming Chapter 11 plan over objection to continued management "in light of

the vast experience" of the individuals employed by the debtor in managing real estate).[6]

Finally, the fact that the on site personnel employed by the debtor's management decided to accept new employment pending confirmation of this case is hardly evidence that the management company is incompetent. Given the uncertainty of the outcome of the case, and the potential for foreclosure followed by loss of employment, it is understandable that the onsite personnel would take the action that they did. However, with plan confirmation, there is no reason to doubt that debtor's management will be able to hire competent replacements.

Objection 8: Section 1129(a)(10)—acceptance by an impaired class.

Whenever a Chapter 11 plan impairs a class of claims, another requirement for confirmation is that "at least one class of claims that is impaired under the plan has accepted the plan." 11 U.S.C. § 1129(a)(10). The debtor seeks to satisfy this requirement by pointing to the affirmative vote of a class of general unsecured creditors.[7] However, the bank

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[6] The bank also argues that Section 1129(a)(5) is violated because the management firm employed by the debtor is paid a management fee of 4% instead of the 3% rate that the bank believes is appropriate. However, Section 1129(a)(5)(B) provides only that the identity and compensation of insiders to be employed by the debtor be disclosed, not that it be approved by the court. *In re All Seasons Indus., Inc.*, 121 B.R. 822, 826 (Bankr.N.D.Ind. 1990). In any event, the evidence presented at the confirmation hearing indicates that the 4% rate is not unreasonable.

[7] If the bank's deficiency claim had been included in this class, its vote against confirmation would have resulted in the class not accepting the plan. However, as noted above, the bank's

(continued...)

argues that this class's vote does not satisfy the requirement of Section 1129(a)(10) because the class was "artificially" impaired.

As the term relates to Chapter 11 plans, "impairment" is defined by Section 1124 of the Code. This section provides, with an exception not relevant here, that every class of claims is impaired, "unless, with respect to each claim . . . of such class" the plan either (1) "leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest" or (2) reverses the acceleration of an indebtedness caused by default, through a defined cure process, and otherwise leaves the rights of the holder of the claim unaltered. Until recently, Section 1124 contained a third ground for finding a claim unimpaired: that "on the effective date of the plan, the holder of such claim . . . receives, on account of such claim . . . cash equal to . . . the allowed amount of such claim." This third ground might have applied to debtor's plan, depending on how the plan was modified to comply with the best interests test. However, the third ground of nonimpairment was deleted by Section 213(d) of the Bankruptcy Reform Act of 1994, Pub. L. 103-394, effective as to cases filed on or after October 22, 1994.

Under current law, the debtor's plan plainly does impair the class of general unsecured claims. The creditors holding these claims are, at the very least, delayed in the right to payment that existed under their agreements with the debtor, and they are not provided interest to which they would

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[7] (...continued)
deficiency claim was placed in a separate class, as required by *In re Woodbrook Assocs.*, 19 F.3d 312, 317-320 (7th Cir. 1994) (separate classification of the deficiency claim of a nonrecourse secured creditor is not only permitted, but required, in light of the unique legal status of such a claim).

otherwise be entitled.[8] However, the bank contends that this impairment is "artificial" and hence should not be recognized, because the debtor had the ability to pay the unsecured creditors, in full, with interest, at the time of the confirmation hearing.

The leading case for denying confirmation on the ground of artificial impairment is *In re Windsor on the River Associates*, 7 F.3d 127 (8th Cir. 1993). *Windsor* was a single asset real estate case in which the secured creditor's claim was oversecured by the debtor's property, and in which the debtor's plan provided that a class of trade creditors would be paid 60 days after the effective date of the plan. The delay in payment effected an impairment under Section 1124, but the Eighth Circuit refused to recognize this impairment. The court held that, "for purposes of 11 U.S.C. § 1129(a)(10), a claim is not impaired if the alteration of rights in question arises solely from the debtor's exercise of discretion." 7 F.3d at 132. Then, because it would have been possible for the debtor to have structured the plan so as to pay the trade debt in full on the effective date, leaving the secured creditor as the only impaired creditor, the court found that an "arbitrary manipulation" of claims had taken place. 7 F.3d at 132-33.

Windsor thus requires the denial of confirmation in any case where it would be possible to structure a plan without an approving impaired class. This rule has been rejected by the

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[8] Under Illinois law, even in the absence of a contractual provision, interest is payable on liquidated debts. 815 ILCS 205/2 (1994); *Premier Elec. Const. Co. v. American Nat. Bank*, 656 N.E.2d 157, 167 (Ill.App. 1995) ("Under Illinois law, absent an express contract provision allowing interest at a specific rate, a party is only entitled to prejudgment interest at the statutory rate from the date payment is due to the date of entry of the judgment.")

Ninth Circuit Bankruptcy Appellate Panel as unsupported by the language of the Code, and as inconsistent with the Code's policy of flexibility in plan formulation. *In re Hotel Assocs. of Tucson*, 165 B.R. 470, 475 (Bankr.9th Cir. 1994); *accord, In re Beare Co.*, 177 B.R. 886 (Bankr.W.D.Tenn. 1994). And even courts that find *Windsor's* rationale persuasive have not applied its rule that impairment under Section 1129(a)(10) must be unavoidable. Rather, these cases have found artificial impairment only where there is no reason for the impairment other than obtaining compliance with Section 1129(a)(10). *In re Investors Florida Aggressive Growth Fund, Ltd.*, 168 B.R. 760, 766 (Bankr.N.D. Fla. 1994) (denying confirmation where compliance with Section 1129(a)(10) was "the only purpose for the impairment of a class"); *In re North Washington Center Ltd. Partnership*, 165 B.R. 805, 810 (Bankr.D.Md. 1994) (denying confirmation where the debtor had "absolutely no reason" for impairing the only accepting class of creditors). Consistent with this view of artificial impairment, the court in *In re Rivers End Apartments, Ltd.*, 167 B.R. 470, 479 (Bankr.S.D.Ohio 1994), confirmed a Chapter 11 plan over an artificial impairment objection because the debtor made a showing that impairment of unsecured claims (by delay in payment) was desirable for business purposes—even though it was not essential—leading the court to find that the delay was "not proposed solely to achieve impairment."

Thus, there appears to be a developing consensus among the decisions that the "artificial impairment" objection is best seen, not as a ground for finding noncompliance with Section 1129(a)(10), but as an argument that a plan has not been proposed in good faith, a separate requirement for confirmation under Section 1129(a)(3), discussed above. This consensus is responsive both to the language of the Code and to the concerns reflected in *Windsor*. As the Bankruptcy Appellate Panel suggests in *Hotel Associates of Tucson*, it is

difficult to hold that a class should not be counted as "impaired," when, by the definition of Section 1124, it plainly is impaired. 165 B.R. at 474. On the other hand, courts should not be required to accept manipulation of the confirmation process, by debtors carving out classes that are likely to confirm the plan, and then treating those classes in a manner that technically impairs them but provides significant incentives to approve the plan. Where such manipulation occurs, it should result in a denial of confirmation under the good faith requirement. *In re Beare Co.*, 177 B.R. at 889 ("[G]ood faith under § 1129(a)(3) is the real issue to be decided, not impairment.").[9]

In the present case, there is no lack of good faith in the system of classification and payment set forth by the debtor's plan. The debtor's operations are not anticipated to generate sufficient income to pay all unsecured claims in full, with interest. Therefore, the debtor had to impair claims. The debtor addressed this situation in a manner that is highly favorable to the noninsider creditors by providing for payment of the principal of all noninsider claims before any payment of insider claims. Presumably, the debtor could have arranged for payment of the trade debt with interest from the time of filing (thus reducing the funds payable to the bank on its unsecured deficiency claim), but nothing in the Code

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[9] The debtor argues that the bank lacks standing to make an artificial impairment argument because it is not a member of the allegedly impaired class. Since the real thrust of the artificial impairment argument is a challenge to good faith under Section 1129(a)(3), the bank plainly has standing to make the argument. *See Big Shanty Land Corp. v. Comer Properties, Inc.*, 61 B.R. 272, 280 (N.D.Ga. 1985) (holding that a creditor of estate has standing to raise good faith argument and that the court has an independent duty to examine good faith in any event).

requires such treatment, particularly when it would result in denial of confirmation for lack of an accepting impaired class.

The plan has been accepted by an impaired class, and there is no lack of good faith in the debtor's failure to pay that class interest on its claims.

Objection 9: Section 1129(a)(11)—feasibility.

The final objection made by the bank is that the debtor's plan fails to meet the requirement of Section 1129(a)(11) that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization of the debtor . . . unless such liquidation or reorganization is proposed in the plan." This provision is commonly referred to as the "feasibility" test. *See* 5 Collier on Bankruptcy ¶ 1129.02[11] (15th ed. 1995) (discussing the derivation of Section 1129(a)(11)). The language of the subsection clearly establishes its reach: "[T]he feasibility standard is whether the plan offers a reasonable assurance of success. Success need not be guaranteed." *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). One recent district court opinion summarized the case law interpreting Section 1129(a)(11) as follows:

> A plan meets this feasibility standard if the plan offers a reasonable prospect of success and is workable. The prospect of financial uncertainty does not defeat plan confirmation on feasibility grounds since a guarantee of the future is not required. The mere potential for failure of the plan is insufficient to disprove feasibility.

In re Patrician St. Joseph Partners Ltd. Partnership, 169 B.R. 669, 674 (D.Ariz. 1994) (citations omitted).

Under this standard, the September 11 plan is plainly feasible. The projected cash flow set out in the court's findings of fact is sufficient to pay all of the debtor's

anticipated expenses, together with required debt service to the bank, for 6 years. Indeed, at the end of that period, the cash flow found by the court will result in "excess" cash flow, in an amount of nearly $7.5 million, paid on the principal of the new note, leaving a loan balance of $43.5 million, even if the debtor's partners fail to make the last three capital contributions required under the plan. See Debtor's Supplemental Post-Trial Memorandum, filed November 3, 1995, Exhibit D. If all of the capital contributions are made, the loan balance would be $41.5 million. *Id.*, Exhibit C. During the seventh year of the plan, due to anticipated expenses in connection with the renewal of the largest tenant's lease, the projected cash flow is not sufficient to make the required debt service. This situation continues in the eighth year of the plan, albeit to a much smaller extent. In the ninth and tenth years of the plan, projected cash flow once again substantially exceeds the amount needed for required debt service.

The bank contends that this situation shows a lack of feasibility, since, as discussed above, the debtor cannot require the bank to relend any of the excess amortization payments at the time of the anticipated shortfalls in cash flow. However, the debtor's inability to force a loan from the bank does not imply failure of the plan. In the situation outlined above, it is likely that the bank will make the loan willingly. The bank would have enjoyed six years of successful operation of the property, and would, at the time of the request for relending, have a debtor with stable income prospects and a defined short term cash flow shortage. Not only would the bank be given a generous return on the short term lending, the ultimate effect of the lending would be to increase the debtor's equity in the property, which equity would inure completely to the bank through participation interest and payment of its unsecured deficiency claim.

Alternatively, the debtor would have the option of selling the property and prepaying the loan without penalty. The experts of each party testified to an improving market for office buildings in the Chicago central business district.

Finally, if the anticipated cash shortfall in the seventh year of the plan cannot be made up by the debtor, there will still be no "liquidation, or the need for further financial reorganization of the debtor." The debtor's plan itself provides for a consensual transfer of the property to the bank in the event of default, and, this feature of the plan is likely to be enforced in any subsequent bankruptcy proceeding.

The debtor has established the feasibility of its plan.

Conclusion

For the reasons set forth above, the court finds that the debtor has established that its September 11 plan complies with all of the applicable requirements of Section 1129 except for Section 1129(a)(7). That deficiency may be remedied either by paying trade creditors in full on the effective date of the plan, or by paying them interest at a comparable treasury rate during the period of any delay in payment. Upon modification of the plan to effect one of these changes, the court will enter an order of confirmation.

Dated: December 5, 1995

/s/ Eugene R. Wedoff
Eugene R. Wedoff
U.S. Bankruptcy Judge

Supreme Court, U.S.
FILED
MAR 31 1998
OFFICE OF THE CLERK

No. 97-1418

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Successor by merger to Bank of America Illinois,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONSE IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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RULE 14.1(b) AND 29.6 STATEMENT

The Respondent, 203 North LaSalle Street Partnership, is an Illinois Limited Partnership. The Respondent has no parent corporation, subsidiaries or affiliates, and no stock in the Respondent is publicly traded.

TABLE OF CONTENTS

PAGE

RULE 14.1(b) AND 29.6 STATEMENT i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

STATEMENT OF THE CASE 1

REASONS FOR DENYING THE WRIT 7

I. THIS CASE IS NOT AN APPROPRIATE VEHICLE FOR CONSIDERING SURVIVAL OF THE NEW VALUE COROLLARY 9

A. Reversing the lower courts would make this the first case in which an unstayed order confirming a substantially consummated plan of reorganization was overturned 9

B. By failing to appeal the bankruptcy court's order denying the Bank's motion to terminate the Debtor's exclusive right to file a plan, the Bank waived its right to raise exclusivity 15

C. The Plan does not violate the absolute priority rule 17

D. Even if the absolute priority rule applies, this case does not present any of the hypothetical dangers upon which critics rely to question the survival of the new value corollary ... 20

II. THERE IS NO SPLIT IN THE CIRCUITS REGARDING THE EXISTENCE OF THE NEW VALUE COROLLARY 25

III. THE STATUS OF THE NEW VALUE COROLLARY IS NO LONGER SUFFICIENTLY IMPORTANT TO REQUIRE DECISION BY THIS COURT 27

CONCLUSION 30

TABLE OF AUTHORITIES

CASES — PAGE(S)

Alsberg v. Robinson, 68 F.3d 312 (9th Cir. 1995) 25

In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993) . . 8, 12, 13, 25, 29, 30

In re Bryson Properties XVIII, 961 F.2d 496 (4th Cir. 1991) . 8, 19, 22, 25, 26, 27

In re Burton Securities, S.A., 202 B.R. 411 (S.D. Tex. 1996) 13

In re Cambridge Biotech Corp., 214 B.R. 429 (D. Mass. 1997) 13

Case v. Los Angeles Lumber Products Co., 308 U.S. 108 (1939) 18, 19

Central States, Southeast and Southwest Areas Pension Funds v. Central Transport, Inc., 841 F.2d 92 (4th Cir. 1988) 13, 14

Church of Scientology v. United States, 506 U.S. 9 (1992) 9

Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Associates, No. 96-5140, slip op. (2d Cir. Feb. 19, 1998) 8, 19, 22, 23, 24, 25, 26, 27

In re Continental Airlines, 91 F.3d 553 (3d Cir. 1996) (en banc) *cert. denied* 117 S. Ct. 686, 136 L.Ed. 2d 610 (1997) 12, 13

Dewsnup v. Timm, 502 U.S. 410 (1992) 25

In re Freeman, 956 F.2d 252 (11th Cir. 1992) 16

In re Greystone III Joint Venture, 995 F.2d 1274 (5th Cir. 1991) 25

Group of Institutional Investors v. Chicago, M.StP.&Pac.R.R. 318 U.S. 523 (1943) 18

Kansas City Terminal R. Co. v. Central Union Trust Co., 271 U.S. 445 (1926) 18, 22

Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990) 24

Matter of Manges, 29 F.3d 1034 (5th Cir. 1994), *cert. denied* 513 U.S. 1152 (1995) 13

Mills v. Green, 159 U.S. 651 (1895) 9

NLRB v. Bildisco and Bildisco, 465 U.S. 513 (1984) 15

Northern P. Ry. Co. v. Boyd, 228 U.S. 482 (1913) 19, 20

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 28, 29

In re Pine Mountain Ltd., 80 B.R. 171 (9th Cir. BAP 1987) 16, 17

In re Public Service Company of New Hampshire, 963 F.2d 469 (1st Cir. 1992), *cert. denied* 506 U.S. 908 (1992) 13

Randall v. Loftsgaarden, 478 U.S. 647 (1986) 19

Matter of Snyder, 967 F.2d 1126 (7th Cir. 1992) 17, 24

In re Texaco, 92 B.R. 38 (S.D.N.Y. 1988) 13

Matter of 203 North LaSalle Street Partnership, 190 B.R. 595 (N.D. Ill. 1995) 14

In re UNR Industries, Inc., 20 F.3d 766 (7th Cir. 1994), *cert. denied* 513 U.S. 999 ..... 9, 11, 12

U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 513 U.S. 18 (1994) 12

In re Wabash Valley Power Association, 72 F.3d 1305 (7th Cir. 1995), *cert. denied* 117 S.Ct. 389 (1996) 18

Matter of Woodbrook Associates, 19 F.3d 312 (7th Cir. 1994) 3, 24

STATUTES

11 U.S.C. § 221 (1938) (repealed 1978) 19

11 U.S.C. § 362(d)(2) 12

11 U.S.C. § 506(a) 2

11 U.S.C. § 1101 11

11 U.S.C. § 1111(b)(1)(A) 2, 23

11 U.S.C. § 1111(b)(2) 2

11 U.S.C. § 1121(b) 5, 16

11 U.S.C. § 1121(d) 16

11 U.S.C. § 1122 25

11 U.S.C. § 1129 26

11 U.S.C. § 1129(a)(7) 16

11 U.S.C. § 1129(b) 18, 19

11 U.S.C. § 1129(b)(2)(A)(i) 2, 3

11 U.S.C. § 1129(b)(2)(B)(ii) 2, 15, 16

11 U.S.C. § 1225(b) 29

12 U.S.C. § 29 1

26 U.S.C. § 469 28

26 U.S.C. §§ 1001, 7701(g) 28

Section 77B of the Bankruptcy Act of 1898 June 7, 1934, 48 Stat. at L. 912, Chap. 424 (repealed) 18, 19

OTHER AUTHORITIES

8 *Collier on Bankruptcy*, ¶1200.01[b] (15th ed. rev. 1997) 29

Baird, *The Elements of Bankruptcy* (rev. ed. 1993) 24

National Bankruptcy Review Commission Final Report, October 20, 1997 30

Warren, *A Theory of Absolute Priority*, *1991 Annual Survey of American Law* ... 21, 24

STATEMENT OF THE CASE

The plan of reorganization (the "Plan"), which has been in effect since December 6, 1995, gives the Bank all cash flow and all future appreciation from the reorganized debtor's ("Reorganized LaSalle") Class A office building (the "Property") until the Bank has received payment in full of its secured and unsecured claims, aggregating $93 million.[1] The Bank's opportunity to benefit from that future appreciation, which the Bank agrees will occur, is facilitated by a $6.125 million new capital contribution from certain of the former Debtor's partners ("Investors"). The Plan provides that the Investors can receive no return whatsoever on or of their investment until the Bank has been paid in full. The Investors made that new capital contribution to defer the tax liability they would have incurred if the Bank had foreclosed on its mortgage.[2] App. at 112a-113a.

The Bank's note was nonrecourse requiring the Bank, under nonbankruptcy law, to look only to the Property for payment. Therefore, in a foreclosure, the Bank would have received only the depressed value of the Property at the time of the foreclosure sale.[3] In a Chapter 7 liquidation, the Bank's deficiency claim would have been disallowed as unenforceable under applicable nonbank-

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[1] The Plan preserves the Bank's deficiency claim in its entirety until that claim has been paid in full.

[2] The Plan eliminated the interests of non-contributing partners. Partners who did contribute new capital received equity interests in Reorganized LaSalle proportionate to their contributions.

[3] Federal banking law requires banks to dispose of saleable foreclosed properties within five years. 12 U.S.C. § 29

ruptcy law. App. at 128a. However, in this Chapter 11 case, pursuant to 11 U.S.C. § 1111(b)(1)(A), the Bank was entitled to be treated as if it had recourse against the Debtor. The Bank had a right, under 11 U.S.C. § 1111(b)(2), to retain a lien upon the Property for its full $93 million claim. But the Bank did not exercise that right. Accordingly, under 11 U.S.C. § 506(a), the Bank's claim was split into two claims: (a) a secured claim equal in amount to the value of the Property and (b) an artificially created unsecured claim for the balance of the Bank's debt. In order to determine the amount of the Bank's secured claim, the bankruptcy court was required to value the Property.

The Bank's $54.5 million secured claim was based on the bankruptcy court's valuation of the Property at $55.8 million, less the disposition costs which the Bank would have incurred if it had sold the Property after foreclosing on its mortgage. App. at 115a. There was no material difference between the Bank's and the bankruptcy court's valuation of the Property. The bankruptcy court's value for the Property was a mere 2.8% less than the value proposed by the Bank's appraiser. App. 108a, 111a.

General Electric Capital Corporation ("GE Capital"), in a letter of intent for refinancing the Property, offered to lend Reorganized LaSalle $54.5 million to pay the Bank's secured claim in cash, in full. App. at 125a-126a. The Bank refused to accept that cash payment, or any plan which would have permitted the Debtor to retain ownership of the Property. App. at 126a. Therefore, in order to confirm its Plan, the Debtor was required to "cram down" the Bank's claims by satisfying the requirements of 11 U.S.C. §§ 1129(b)(2)(A)(i) and 1129(b)(2)(B)(ii).

The Plan treated the Bank's secured claim more favorably than the treatment required by the marketplace as evidenced by GE Capital's letter of intent. Thus, although the Bank voted its secured claim to reject the Plan, the bankruptcy court found that the Plan's treatment of that claim satisfied the requirements of Section 1129(b)(2)(A)(i). App. at 172a.

As required by the Seventh Circuit's decision in *In the Matter of Woodbrook Associates*, 19 F.3d 312, 319 (7th Cir. 1994), the Plan placed the Bank's artificial deficiency claim in a class by itself, separate and apart from creditors holding recourse unsecured claims. Under the Plan, this artificial deficiency claim receives all proceeds from a sale or refinancing of the Property remaining after payment of the Bank's secured claim until that deficiency claim is paid in full. App. at 132a-133a. The bankruptcy court projected that a sale or refinancing of the Property on the tenth anniversary of plan confirmation would produce a $19 million distribution to the Bank on account of its deficiency claim, representing a 16% dividend on a present value basis. App. at 133a. If the Property is refinanced rather than sold on or before the tenth anniversary of confirmation of the Plan, the potential exists for the Bank to receive an even greater dividend when the Property is refinanced again or sold after the tenth anniversary of Plan confirmation.[4]

The Bank was not the only creditor in this case. The general partner of the Debtor and an affiliate held al-

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[4] The Plan does not discharge the Bank's deficiency claim. Thus, if the first mortgage is paid through successive refinancings, the deficiency will continue to exist and the potential exists for the Bank to benefit from those refinancings until its deficiency claim is paid in full.

lowed unsecured claims totaling $7.7 million; the general partner held another claim based upon a $11.3 million second mortgage. App. 103a, 129a. Under the Plan, insiders waived all of these claims, even though the $7.7 million of unsecured claims held by the general partner and its affiliate would have received a distribution of approximately $3 million in a Chapter 7. App. at 129a-130a. Under the Plan, that money was reinvested in the Property. In addition, general unsecured trade debt of about $160,000 was paid in full pursuant to the Plan. App. at 103a, 132a.

Of the $6.125 million new capital contribution, $3 million was paid in cash on the day after confirmation; the balance was payable in installments of $625,000 on the first five anniversaries of plan confirmation. *Id.* The first two deferred payments totaling $1,250,000 have already been made. The remaining payments are partially secured by a letter of credit which, in turn, has been guaranteed by an affiliate of the general partner. App. at 123a. The amount and terms of the new capital contribution were more favorable to the Bank than the amount and terms required by the marketplace in the form of the GE Capital letter of intent. App. at 125a-126a, 127a n4. Unlike that letter of intent, which permitted a 9% annual return on (and a return of) new capital before any payment to the deficiency claim, the Plan fully subordinated the new capital contribution to the Bank's artificial deficiency claim. *Id.*, 135a. Indeed, the bankruptcy court found that the equity interests in Reorganized LaSalle have no value "on the market". App. 139a.

The Bank filed a motion in the bankruptcy court seeking to terminate the Debtor's exclusive right to file a

plan, a right conferred by 11 U.S.C. § 1121(b). The Bank also sought leave to file its own plan that called for liquidation of the Property, and made no provision either for contribution of new capital or for any payment to the $7.7 million of allowed unsecured claims held by insiders. The bankruptcy court denied the Bank's motion. **The Bank did not appeal that denial or raise that denial as an issue on appeal when the Debtor's Plan was confirmed.**

Following confirmation of the Plan, the Bank moved both in the bankruptcy court and in the district court for a stay pending appeal. The Bank refused to post a supersedeas bond. As a result, its motions for stay pending appeal were denied. Thereafter, Reorganized LaSalle implemented the Plan.

Specifically, as set forth in Debtor's Supplemental Status Report on Plan of Reorganization filed on December 27, 1995 (the "SSR"), *see Appellee's Memorandum In Support Of Motion To Dismiss*, filed in the Seventh Circuit February 5, 1996 at Ex. F, (a) certain partners in the Debtor contributed $3 million of cash and $3,125,000 of notes payable in five annual installments of $625,000 to Reorganized LaSalle as new equity capital (*Id.* at Ex. D at Wilkow Aff. ¶ 3) (two of the five annual installment payments have already been made); (b) the cash component of Reorganized LaSalle's new equity capital, together with $3.1 million of cash which the Debtor held before the Chapter 11 filing, was used to pay (i) $2,277,257.39 of delinquent real estate taxes, (ii) $1,149,500 to the Bank on account of its restructured first mortgage loan, (iii) a $266,975 commitment fee to the Bank, (iv) a $1,850,000 payment to Rudnick & Wolfe, a major tenant of the Property, in connection

with the seven-year extension of Rudnick & Wolfe's lease with Reorganized LaSalle, which lease extension was effective only if and when the Plan was confirmed, (v) a $400,000 commission to Equis, Rudnick & Wolfe's leasing broker, (vi) a $181,000 commission to M & J Wilkow Brokerage Services Corporation, the landlord's leasing broker, and (vii) $88,377.87, representing payment in full, to all 41 of the Debtor's non-insider unsecured trade creditors.

Pursuant to the Plan, Reorganized LaSalle has also: (a) delivered to the Bank all of the documents reflecting the restructuring of the Bank's first mortgage loan effected by the Plan, (b) rejected all of the Debtor's prepetition contracts with providers of goods and services to Reorganized LaSalle; (c) hired new on-site property management personnel; and (d) entered into new service agreements. *Id.* at Ex. F SSR; *Id.* at Ex. D Wilkow Aff. at ¶4. The partnership interests of those partners who did not contribute new equity capital to the Reorganized Debtor have been eliminated (*Id.* at Ex. A Plan §5.2 at 17) and resulting income tax consequences have been realized.

Relying upon the Confirmation Order and the resulting deferral of tax liability, several Investors chose not to structure the sale of other real estate owned by them as a tax free exchange.

REASONS FOR DENYING THE WRIT

The Bank's petition for a writ of certiorari (the "Petition") should be denied for the following reasons:

1. This case is not an appropriate vehicle for deciding whether the new value corollary to the absolute priority rule survived enactment of the Bankruptcy Code in 1978 because:

a) This case is equitably moot. The Bank failed to obtain a stay pending appeal following entry of the confirmation order. As a result, the Plan has been consummated. In reliance on the final order confirming the Plan, investors have contributed millions of dollars to the reorganized enterprise. Any attempt to unwind transactions that occurred nearly two and a half years after confirmation, would seriously jeopardize future Chapter 11 reorganizations by undermining investors' confidence in their ability to invest in reorganized companies in reliance on final unstayed bankruptcy court orders.

b) The Bank's primary criticism of the Plan is that it purportedly gave the Debtor's equity holders the "exclusive opportunity" to retain interests in the reorganized debtor. However, the Bank waived the issue of exclusivity by failing to raise it on appeal below.

c) The Plan does not violate the absolute priority rule. Investors did not receive any property which would have been available to satisfy creditors' claims.

d) The Plan does not involve any of the alleged dangers which have caused critics of the new value corollary to question its continued existence. Not only was the bankruptcy court's

> valuation of the Property consistent with the value attributed to the Property by the Bank's appraiser, but the new capital contribution exceeded the requirements of an independent lender in the marketplace. Significantly, the Bank does not claim that the Plan causes any of the putative harms which the Bank ascribes to the new value corollary.

2. There is no split in the Circuits regarding the existence of the new value corollary. The Seventh Circuit in this case and the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993) have both held that the new value corollary survived enactment of the Bankruptcy Code in 1978. No circuit court has held to the contrary. Both the Second Circuit in *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Associates*, No. 96-5140, slip op. (2d Cir. Feb. 19, 1998) and the Fourth Circuit in *In re Bryson Properties XVIII*, 961 F.2d 496 (4th Cir. 1991) suggest that a debtor's equity holders may retain their interest in the reorganized debtor under certain circumstances. Such circumstances are present in this case. Neither *Coltex* nor *Bryson Properties* held that the new value corollary ceased to exist after enactment of the Bankruptcy Code.

3. The question of the new value corollary's survival is no longer sufficiently important to justify consideration by this Court. The issue has arisen primarily in single asset real estate and family farm Chapter 11 cases, which constituted a mere fraction of all Chapter 11 filings.

4. The Seventh Circuit's decision in this case was correct both as a matter of law and as a matter of bankruptcy policy.

I.

THIS CASE IS NOT AN APPROPRIATE VEHICLE FOR CONSIDERING SURVIVAL OF THE NEW VALUE COROLLARY.

A. Reversing the lower courts would make this the first case in which an unstayed order confirming a substantially consummated plan of reorganization was overturned.

The Petition should be denied as equitably moot, even if the question presented merits this Court's attention.[5] This case should never have spawned any appellate decisions on the new value corollary, because the Bank's appeals from the unstayed Confirmation Order should have been dismissed as equitably moot. The district and circuit courts in this case improperly refused to dismiss the Bank's appeals to them as equitably moot. Affirming the bankruptcy court's entry of the Confirmation Order on the merits, the district and circuit courts theorized that, had they reversed the Confirmation Order, the bankruptcy court could have fashioned some form of relief which would not unduly burden innocent third parties. App. at 11a, 60a. Clearly, modification of the Plan would upset the legitimate expectations of the Investors, who were not parties to the appeal. Nevertheless, the Seventh Circuit brushed that fact aside because

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[5] The doctrine of equitable mootness is separate and distinct from mootness under Article III of the Constitution. The latter doctrine requires dismissal of an appeal when circumstances make it *impossible* for a court to fashion any form of meaningful relief. *Church of Scientology v. United States*, 506 U.S. 9 (1992); *Mills v. Green*, 159 U.S. 651 (1895). When an appellant invokes equitable mootness, the reviewing court must consider whether it is "*prudent*" to upset a plan of reorganization long after confirmation. *In re UNR Industries, Inc.*, 20 F.3d 766, 769 (7th Cir. 1994), *cert. denied* 513 U.S. 999.

the Bank had consented to repay the investments plus reasonable interest. Repayment to the Investors is not what they legitimately expected when they made their investments in reliance upon the unstayed Confirmation Order. They purchased deferral of tax liabilities for an extended period.

The Seventh Circuit ignored the universal unwillingness of appellate courts to reverse unstayed confirmation orders. This Court should not compound the damage already done to the equitable mootness doctrine by the lower courts in this case by considering the merits, and should deny the Petition. If this Court wishes to examine the new value corollary, it should wait for a case arising from a confirmation that has been stayed, a case not burdened with the equitable mootness issue.

In order to protect legitimate reliance interests of participants in the Chapter 11 process, it is important that the Court deny this Petition seeking review of an *unstayed* confirmation order. The very consideration of this case on its merits will cast doubt on the finality of confirmation orders, even if this Court should ultimately affirm. No appellate court has ever found a reason in the facts of any reported case powerful enough to reverse an unstayed confirmation order. In this case, the Bank offered no reason whatsoever, and omitted any reference to the absence of a stay in its Statement of the Case. Any benefit to be obtained from considering this case on its merits, would be far outweighed by the harm which would flow from disregarding equitable mootness.

The Bank did not obtain a stay pending appeal, because it was unwilling to furnish a supersedeas bond and assume the attendant liability on such a bond in the event the bankruptcy court's confirmation order was

affirmed. Nevertheless, the Bank seeks to dismantle the plan of reorganization confirmed and consummated more than two years ago.[6] Reversal of the Confirmation Order at this late stage would completely repudiate the well-settled doctrine of equitable mootness and would undermine the confidence of investors, lenders and purchasers in the finality and reliability of confirmed reorganization plans.

Not only the risk of revision of a confirmed plan on appeal, but the mere pendency of an appeal itself, discourages business people from making substantial investments in reorganized debtors. The appellate process itself is expensive and sophisticated entrepreneurs will deduct the cost of appeals from the amount they are willing to pay for interests in reorganized debtors. Potential investors in a reorganized debtor will hold back their best offer unless they are certain that, absent a stay, the reorganized enterprise will operate free of judicial interference following confirmation of a reorganization plan.

Only if investors can confidently rely upon the finality of such orders will the substantial social and private value of reorganizations, referred to by the Seventh Circuit *In the Matter of UNR Industries, Inc.*, 20 F.3d

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[6] 11 U.S.C. § 1101(2) defines substantial consummation as:

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;

(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

766, 771 (7th Cir. 1994), *cert. denied* 513 U.S. 999 be fully realized.

In support of his conclusion that an appeal from an unstayed confirmation order in that case should be dismissed, Judge Easterbrook trenchantly[7] observed that:

> Every incremental risk of revision on appeal puts a cloud over the plan of reorganization and derivatively over the assets of the reorganized firm. People pay less for assets that may be snatched back or otherwise affected by subsequent events.
>
> . . . .
>
> By protecting the interest of persons who acquire assets in reliance on a plan of reorganization, a court increases the price the estate can realize *ex ante* and thus produces benefits for creditors in the aggregate.

Id. at 770.

The Bank notes that this Court granted certiorari to consider the existence of the new value corollary to the absolute priority rule in *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18 (1994). However, that case did *not* involve an appeal from an unstayed order confirming a substantially consummated reorganization plan. Rather, that case involved an appeal from an order reversing a lower court order granting a secured creditor's motion for relief from the automatic stay under 11 U.S.C. § 362(d)(2). *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993). Consequently, the equitable mootness doctrine was not implicated by this Court's grant of certiorari in *Bonner Mall*.

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[7] *In re Continental Airlines*, 91 F.3d 553, 559 (3d Cir. 1996) (en banc) *cert. denied* 117 S. Ct. 686, 136 L.Ed. 2d 610 (1997) where the Third Circuit characterized Judge Easterbrook's opinion as "trenchant."

Under the equitable mootness doctrine, courts decline to consider the merits of appeals from confirmation orders when, as a result of substantial consummation of a reorganization plan, it is no longer prudent to grant relief. *Matter of Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994), *cert. denied* 513 U.S. 1152 (1995). The equitable mootness doctrine promotes the "important public policy favoring orderly reorganization and settlement of the debtor's estate by 'affording finality to the judgments of the bankruptcy courts'."; *In re Public Service Company of New Hampshire*, 963 F.2d 469, 471-472 (1st Cir. 1992), *cert. denied* 506 U.S. 908 (1992), *quoting In re Texaco*, 92 B.R. 38, 45 (S.D.N.Y. 1988). *See also In re Continental Airlines*, *supra* at 560; *Central States, Southeast and Southwest Areas Pension Funds v. Central Transport, Inc.*, 841 F.2d 92, 95 (4th Cir. 1988); *In re Cambridge Biotech Corp.*, 214 B.R. 429, 431-432 (D. Mass. 1997) (under Section 1127(b) of the Code, court's power to modify a plan of reorganization extends only from confirmation to substantial consummation); *In re Burton Securities, S.A.*, 202 B.R. 411, 417 (S.D. Tex. 1996).

In *Central States*, *supra*, a dissident creditor who failed to post a su rsedeas bond sought complete reversal of a confir ed reorganization plan after new equity had been invested and used to pay claims. In dismissing the appeal as moot, the court stated as follows:

> We can understand a reluctance to put up a supersedeas bond of $7 million but if the [appellant] Pension Fund seriously sought an outright reversal of the order of confirmation, as it contends, it should have posted the bond or sought

> a substantial reduction in its amount; it should not have sat idly by while this case drifted along a routine, unexpedited course.

841 F.2d at 95. Just like the appellant in *Central States*, the Bank refused to post a supersedeas bond that would have stayed implementation of the Plan, and would have prevented investors from relying on the Confirmation Order to make their substantial infusion of new equity nearly two and one-half years ago.[8] Such a bond would also have preserved the status quo for appellate courts and prevented the comprehensive change in circumstances that has now occurred as a result of substantial consummation of the Plan. *See Matter of 203 North LaSalle Street Partnership*, 190 B.R. 595 (N.D. Ill. 1995). Having failed to preserve the status quo and having permitted a comprehensive change in circumstances to occur, the Bank must bear the consequences of its refusal to post a bond—denial of its Petition.

Granting certiorari and reversing the unstayed Confirmation Order years after substantial consummation would eliminate the compelling and well-settled doctrine of equitable mootness from bankruptcy jurisprudence, thereby causing the significant economic harm described

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[8] In making these capital contributions, many of the Investors have foregone significant alternative investment opportunities. *See Appellee's Memorandum In Support Of Motion To Dismiss*, February 5, 1996 at Ex. B. These opportunities cannot be recreated if the Confirmation Order is reversed. For example, some Investors have irretrievably lost the opportunity to engage in a tax free exchange regarding a completed sale of other property. Those Investors will suffer irreparable harm if the Confirmation Order is now reversed, because they have used up losses which could have been used to offset the gain resulting from foreclosure on the Property.

by Judge Easterbrook in *UNR*, and drastically curtailing rehabilitation under Chapter 11. *See NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 527-529 (1984) (policy of Chapter 11 is to permit successful rehabilitation of debtors and to avoid liquidation with attendant loss of jobs and possible misuse of economic resources). If this Court wishes to consider the continued survival of the new value corollary, it should await a case where the petitioner has preserved the status quo. This is not such a case. Certiorari should, therefore, be denied.

B. By failing to appeal the bankruptcy court's order denying the Bank's motion to terminate the Debtor's exclusive right to file a plan, the Bank waived its right to raise exclusivity.

An essential element of the Petition is the contention that the Debtor's statutory exclusive right to file a plan during the first 120 days of the Chapter 11 case constituted "property" which the Debtor's limited partners retained "on account of" their prior equity interests within the meaning of 11 U.S.C. § 1129(b)(2)(B)(ii). For example, in the "Question Presented" Section of the Petition, the Bank asks,

> [w]hether the Bankruptcy Code authorizes a judge to confirm a Chapter 11 plan of reorganization that grants pre-bankruptcy equity owners of a debtor an *exclusive opportunity* to retain or purchase an ownership interest in the reorganized debtor . . .

Petition at i (emphasis added). Thereafter, the Bank argues that, "the exclusive right to retain an equity interest in a business enterprise is 'property' within the meaning of 11 U.S.C. § 1129(b)(2)(B)(ii) . . ." Petition at 9. The Bank has waived its right to complain of exclu-

sivity. Consequently, this is not an appropriate case for considering the issue posed by the Bank's Petition.

A Chapter 11 debtor's exclusive right to file a plan is conferred by 11 U.S.C. § 1121(b) of the Code. That right is not perpetual; it exists only for the first 120 days of a Chapter 11 case and, even during that period, is subject to reduction upon request by a creditor such as the Bank. 11 U.S.C. §§ 1121(b), 1121(d). The obvious remedy for the wrong perceived by the Bank—inability to solicit bids for Reorganized LaSalle's equity through a competing plan of reorganization—was to request termination of the Debtor's exclusive period.

The Bank did move in the bankruptcy court for an order terminating the Debtor's exclusivity period. Simultaneously, the Bank sought authority to file its own plan. The Bank's plan was a plan of liquidation, which (a) was less favorable to unsecured creditors than the Debtor's Plan, (b) violated 11 U.S.C. §1129(a)(7) by failing to pay $7.7 million of allowed unsecured claims held by the Debtor's general partner and an affiliate, and (c) provided no infusion of new capital. The bankruptcy court entered an order denying the Bank's motion. BAI R. 104. **The Bank did not (a) appeal the bankruptcy court's order, (b) raise the denial of its motion as an issue on appeal or (c) designate its motion to terminate the Debtor's exclusive period as part of the record on appeal below.** By failing to do so, the Bank waived any right to now argue that the Debtor's exclusive right to file a plan permitting its partners to contribute new capital constitutes "property" retained "on account of" their prior equity interests within the meaning of 11 U.S.C. § 1129(b)(2)(B)(ii). *In re Freeman*, 956 F.2d 252, 255 (11th Cir. 1992); *In re Pine Mountain*

Ltd., 80 B.R. 171, 173 (9th Cir. BAP 1987). As a result of that waiver, the question presented by the Bank's Petition is not properly before this Court.

C. The Plan does not violate the absolute priority rule.

By acquiring worthless "equity" in Reorganized LaSalle in exchange for contributing new value, Investors received no "property" which would have been available to satisfy creditors' claims. In return for $6.125 million of new value, Investors received only the ability to defer a $20 million tax liability that would have been triggered by the Bank's foreclosure of its mortgage on the Property. That ability is not "property" to which creditors could look for payment under the absolute priority rule, which rule requires that creditors be paid in full from a debtor's property before any interest in that property may be received or retained by equity holders. On the contrary by contributing new value, the Investors conferred a substantial windfall on the Bank, because of their desire to defer tax liability. The Plan simply does not cause the harm to the Bank's deficiency claim which the absolute priority rule was intended to prevent.

The absolute priority rule was a judicial creation which had its origins in the law of fraudulent transfers and equity receiverships, and was designed to ensure that reorganizations were "fair and equitable". *In the Matter of Snyder*, 967 F.2d 1126, 1128 n.1 (7th Cir. 1992). As the Seventh Circuit recently observed:

> the absolute priority rule was a judicial invention designed to preclude the practice in railroad reorganizations of 'squeezing out' intermediate

> unsecured creditors through collusion between secured creditors and stockholders (who were often the same people). *Northern P. Ry. Co. v. Boyd*, 228 U.S. 482, 57 L.Ed. 931, 33 S.Ct. 554 (1913). *See also* e.g. John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich.L.Rev. 963, 969-73 (1989) discussing the history of the absolute priority rule. This rule was thus devised primarily to deal with the situation of overlapping ownership and creditor interests.

In re Wabash Valley Power Association, 72 F.3d 1305, 1314 (7th Cir. 1995), *cert. denied*, 117 S.Ct. 389 (1996).

As used in subsection (f) of the first corporate reorganization statute (Section 77B of the Bankruptcy Act of 1898 June 7, 1934, 48 Stat. at L. 912, Chap. 424 (repealed)), the words "fair and equitable" were "words of art which, prior to the advent of § 77B had acquired a fixed meaning through judicial interpretation in the field of equity receivership reorganizations." *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 108, 115 (1939). That meaning was clear and simple: "to the extent of their debts, creditors are entitled to priority over stockholders against *all property* of an insolvent corporation." *Id.* (quoting *Kansas City Terminal R. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926) (emphasis added); *see also*, *Group of Institutional Investors v. Chicago, M.StP.&Pac.R.R.* 318 U.S. 523, 565 (1943). (absolute priority rule is satisfied if "each security holder in the order of his priority receives *from that which is available for satisfaction of his claim*, the equitable equivalent of the right surrendered.") (emphasis added).

The words "fair and equitable" which appear in 11 U.S.C. § 1129(b) are identical to the words which appeared in its predecessors, Section 77B and Chapter X.

11 U.S.C. § 221 (1938) (repealed 1978). The meaning of those words in 11 U.S.C. § 1129(b) is identical to the meaning ascribed to them by Justice Douglas in *Case*. In interpreting the words "fair and equitable", in Section 77B, Justice Douglas employed the same well-settled rule of statutory construction that this Court should employ in interpreting those same words in Section 1129(b): "where words are employed in an act which at the time had a well known meaning in the law, they are used in that sense unless the context requires the contrary." *Case* at 115.

The Investors retain their valueless partnership interests in Reorganized LaSalle in exchange for contributing new value. Clearly, therefore, the Plan does not involve the type of harm to creditors which the absolute priority rule was designed to prevent. Unlike parties in *Northern P. Ry. Co. v. Boyd*, 228 U.S. 482 (1913), the Bank and the Investors are adversaries. The Plan is not the product of collusion between them. Unlike the plans in *Coltex* and *Bryson*, the Plan preserves the Bank's artificial deficiency in its entirety until that claim has been paid in full. Therefore, the Plan does not divert to the Investors any property of the Debtor in which the Bank had a legal or equitable claim as an unsecured creditor. Indeed, it is undisputed that the equity interests in Reorganized LaSalle are worthless in a balance sheet sense, even after Reorganized LaSalle has received all of the Investors' new capital. The "benefit" which the Investors receive is continued deferral of a tax liability which only they will suffer in the event of a foreclosure. The Bank has no legal or equitable claim to that benefit. See *Randall v. Loftsgaarden*, 478 U.S. 647, 665-66 (1986) (tax losses have no value apart from investors' status as partners and are not freely transferable).

Given the facts of this case, the Court in *Boyd* would have found no violation of the absolute priority rule.

D. Even if the absolute priority rule applies, this case does not present any of the hypothetical dangers upon which critics rely to question the survival of the new value corollary.

Assuming that the absolute priority rule applies to this case, and relying exclusively on secondary material, dissents and dicta, the Bank's Petition proffers two reasons why the question of the new value corollary's continued existence purportedly has sufficient practical import to warrant consideration by this Court: (1) absence of the corollary will make debtors more willing to negotiate consensual plans with creditors [Petition at 16-17]; and (2) in applying the corollary, bankruptcy judges might undervalue estate assets, thereby decreasing "the amount paid to creditors, while at the same time permitting the debtor's pre-bankruptcy equity holders to retain an ownership interest in the post-bankruptcy business at a bargain price." Petition at 16-18. Those concerns are chimerical. Neither of the foregoing circumstances exist in this case. Consequently, this case is not an appropriate one for considering the new value corollary's continued existence. Certiorari should, therefore, be denied.

The Bank does not claim that the bankruptcy court's recognition of the new value corollary made the Debtor unwilling to negotiate with the Bank over the terms of a reorganization plan. Nor does the Bank claim that the Debtor refused a request by the Bank either for a greater dividend or for more capital. In fact, the Bank's attempts to (a) lift the automatic stay, (b) have the case

dismissed or converted to a Chapter 7 liquidation and (c) to file a liquidating plan giving the Bank title to the Property and providing no new capital, demonstrate that the Bank's sole object throughout this case has been to foreclose its mortgage on the Property. As a result, it was the Bank, not the Debtor, which refused to negotiate on the terms of any consensual reorganization plan. The Bank does not even suggest that the Debtor used the new value corollary to impose on any of the creditors a worse deal than creditors would have received without that corollary. On the contrary, in conjunction with equity holders' desire to defer a substantial tax liability, the new value corollary produced a *windfall* for the Bank by forcing equity holders to make a substantial new capital contribution in exchange for an equity interest which had no value to creditors.[9]

Similarly, the record in this case provides no basis for the Bank's fear that bankruptcy judges will undervalue a debtor's property, thereby enabling equity holders to obtain a bargain at creditors' expense. On the contrary, the $55.8 million value which the bankruptcy court placed on the Property is within 2.8% of the $57.4 million value proposed by the Bank's appraiser. In addition, since the Plan preserves the Bank's unsecured claim in

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[9] Unlike the academic critics cited in the Bank's Petition, Harvard Law School's Professor Elizabeth R. Warren presciently anticipated that factors extraneous to a debtor's assets, such as limited partners' desire to defer a potential tax liability that would accrue through a secured creditor's foreclosure of its mortgage, could force those limited partners to confer a windfall on creditors by *overpaying* for equity in a reorganized debtor. Warren, *A Theory of Absolute Priority, 1991 Annual Survey of American Law* at 21. This is precisely what happened in this case.

its entirety, and since the Investors (unlike the equity holders in *Coltex* and *Bryson*) can receive nothing until the Bank's unsecured claim is paid in full, the bankruptcy court's valuation of the Property has no impact on the Bank's ability to recover the full amount of its unsecured claim.

The Bank does not even suggest that the Investors received their equity in Reorganized LaSalle at a bargain price. On the contrary, the amount of new capital contributed by the Investors met and surpassed the requirements of the marketplace as evidenced by the GE Capital letter of intent. This independent corroboration from the market regarding the sufficiency and fairness of the Investor's new capital contribution satisfies the desire for market validation of new capital contributions expressed by Judge Restani in the *Coltex* and *Bryson Properties* cases. Furthermore, because the Plan permits no return whatsoever to Investors on account of their $6.125 million capital contribution until the Bank's secured claim and unsecured artificial deficiency claims have been paid in full, the equity in Reorganized LaSalle has *no value vis a vis* the proceeds that will be realized from a future sale or refinancing of the Property. App. at 135a, 139a. By retaining worthless interests in Reorganized LaSalle in exchange for their substantial contribution of new value, the Investors received *no property of Reorganized LaSalle*. Instead, Investors received only the ability to defer a $20 million tax liability that would have been triggered by a foreclosure. That deferral is not "property" of the Debtor to which the Bank could look to satisfy its artificial deficiency claim. *Kansas City Terminal R. Co. v. Central Union Trust Co.*, 271 U.S. 445, 453-454 (1926) (under absolute priority rule unsecured creditors are preferred

over stockholders against property belonging to debtor corporation). Consequently, it bears repeating that under the Plan, the Debtor's equity holders have received no benefit at creditors' expense. Rather, they have conferred a substantial windfall on the Bank solely because of their desire to defer a potential tax liability.[10]

It is noteworthy that neither the Bank nor any of its academic supporters has cited a single case involving a confirmed plan of reorganization, affirmed on appeal, where the new value corollary was used to inflict on creditors the harm which the Bank speculates may flow from that corollary. On the contrary, in cases such as *Coltex*, where it appears that equity holders did attempt to undervalue the bank's collateral and obtain a bargain at the expense of a bank's artificial deficiency claim, the

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[10] Nowhere in its Petition has the Bank identified any economic harm which it suffered under the Plan. Nor has the Bank articulated a rational economic reason for opposing the Plan. On the contrary, as the holder of an artificial deficiency claim created solely by the operation of 11 U.S.C. § 1111(b)(1)(A), the Bank's opposition to the Plan is *antithetical* to the Bank's economic interest as an unsecured creditor. But for the new value corollary, the Bank's decision to vote its artificial deficiency claim against the Debtor's Plan would lead to conversion of the Debtor's case to a Chapter 7 liquidation, or to dismissal of the case. In either event, the Bank would foreclose on its non-recourse mortgage and have no deficiency claim. Thus, in a foreclosure, the Bank would forfeit the $19 million dividend which it is projected to receive under the Plan on account of its artificial $38.5 million unsecured deficiency claim. No rational *unsecured* creditor would vote to defeat a plan paying it a $19 million dividend so that it could receive nothing in a Chapter 7 liquidation. Consequently, the Bank's argument against the new value corollary can only be seen as a transparent back door attack upon the bankruptcy court's finding that the Plan's treatment of the Bank's *secured claim* is "fair and equitable."

confirmation order was reversed.[11] Similarly, in the vast majority of reported decisions discussing the new value corollary, courts decline to even reach the question of the corollary's survival because they find that the plan in question would not have satisfied the corollary in any event. *See e.g. Matter of Woodbrook Associates*, 19 F.3d 312 (7th Cir. 1994); *Matter of Snyder*, 967 F.2d 1126 (7th Cir. 1992). In other words, all of the empirical evidence demonstrates that courts have interpreted the new value corollary strictly, and have been vigilant in protecting the rights of creditors from the potential harms hypothesized by the Bank and by the corollary's academic critics. The Bank's fears that bankruptcy courts will fail to do so are fanciful, and there is no need for this Court's involvement.

In short, the Plan in this case simply does not present the hypothetical problem which caused critics of the new value corollary such as Judge Easterbrook in *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990), and Professor Baird in *The Elements of Bankruptcy* (rev. ed. 1993) at 263, to speculate that equity holders will invoke the new value corollary only when they are gaining at creditors' expense. See *Absolute Priority* at 21 (investors in tax driven partnership may be willing to make new value contributions far exceeding those of a third party), and 44-45. Consequently, this case is not an appropriate vehicle for addressing the continued existence of the new value corollary.

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[11] The confirmation order in *Coltex* was stayed pending appeal. Thus, the creditor's appeal in that case was not equitably moot.

II.

THERE IS NO SPLIT IN THE CIRCUITS REGARDING THE EXISTENCE OF THE NEW VALUE COROLLARY.

In addition to the Seventh Circuit in this case, the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993) has explicitly held that the new value corollary survived enactment of the Bankruptcy Code. No Circuit Court of Appeals has held otherwise.[12] Citing the *Coltex* and *Bryson Properties* decisions from the Second and Fourth Circuits, the Bank asserts that the opinion of the panel majority in this case conflicts with the decisions of two other circuits. Petition at 11. There is no such conflict. Neither *Coltex* nor *Bryson Properties* denies the existence of the new value corollary. On the contrary, as the Bank candidly acknowledges, each of those decisions recognizes that there may be circumstances under which a debtor's equity holders may retain their interest in a reorganized entity in exchange for an infusion of new capital. Those circumstances are present in this case.

In *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1991), Judge Restani of the United States Court of International Trade, sitting by designation, held that the debtor's plan could not be confirmed because the plan placed the undersecured creditor's deficiency claim in a separate class in violation of 11 U.S.C. § 1122.

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[12] The portion of the Fifth Circuit's opinion in *In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991) denying the existence of the new value corollary was withdrawn in light of this Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992). *See Greystone III* at 1284. An opinion which has been withdrawn has no precedential value. *Alsberg v. Robinson*, 68 F.3d 312, 315 (9th Cir. 1995).

Therefore, the court's subsequent discussion of the new value corollary is dictum. Even in that discussion, however, the court did not absolutely deny the continued existence of the new value corollary. Rather, the court observed that "even if some limited new value exception were viable under the bankruptcy code, it would not be so expansive as to apply *under the facts of this case*." *Id.* at 505 (emphasis added). Those facts were plan provisions allowing the debtor's equity holders the right (1) to return of their new capital *before* the undersecured creditor's recovery on it deficiency claim; (2) to "buy" the debtor's property without exposing it to the market or otherwise allowing any other party, including the objecting undersecured creditor, the opportunity to bid; and (3) to pay a 3.5 percent dividend in full satisfaction of the undersecured creditor's $3,329,288 deficiency while simultaneously paying unsecured trade claims in full. *Id.* at 499, 504-505.

In *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Associates*, No. 96-5140, slip op. (2d Cir. Feb. 19, 1998) Judge Restani, this time writing for a panel of the Second Circuit, again concluded that a debtor may be able to confirm a new value cramdown plan under certain circumstances:

> [w]here no other party seeks to file a plan or where the market for the property is adequately tested, old equity may be able to demonstrate that it can meet the requirements of 11 U.S.C. § 1129 and that, in essence, it receives nothing on account of its prior position.

Although the discussion leading up to this conclusion includes a lengthy quotation from Judge Kanne's dissent in this case, Judge Restani stops short of denying the existence of the new value corollary.

Notably, the facts of this case are materially different from the facts present in both *Bryson Properties* and *Coltex*. In each of those cases, the court was properly concerned that the proposed contributions of new capital had not been tested by the marketplace to determine whether those contributions were reasonably equivalent to the value of the interests to be retained by the old equity holders. The courts' concerns arose because each plan proposed to eliminate the undersecured creditor's deficiency claim in exchange for a small up front cash payment, thereby allowing equity holders to capture future appreciation in the reorganized debtor's asset that would otherwise been available to satisfy the eliminated deficiency claim. In this case, the Bank's deficiency claim is preserved, and the bankruptcy court had ample, objective evidence to support its finding that the interests which equity holders retained in Reorganized LaSalle were not purchased at a bargain price. Under the circumstances of this case, even Judge Restani would have confirmed the Debtor's Plan.

III.

THE STATUS OF THE NEW VALUE COROLLARY IS NO LONGER SUFFICIENTLY IMPORTANT TO REQUIRE DECISION BY THIS COURT.

The issue of the new value corollary's continued existence has arisen primarily in Chapter 11 cases filed by partnerships which own a single commercial real estate project.[13] By filing Chapter 11, such partnerships

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[13] Prior to passage of the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, family farmers also filed Chapter 11 cases in order to save their farms from bank foreclosures.

attempt to prevent a foreclosure sale of the partnership's property and elimination of equity interests, because those events trigger recapture of partnership losses which have been passed through to partners during prior tax years. 26 U.S.C. §§ 1001, 7701(g), 702. The partners are required to treat those recaptured losses as taxable income. Typically, the partners are left without funds from the partnership with which to pay the often sizeable tax on the resulting "phantom income".

In the 1986 Tax Reform Act, Congress amended the Internal Revenue Code to eliminate the ability of passive investors in single asset real estate partnerships to offset losses which they received as limited partners against wages and portfolio income. See Tax Reform Act of 1986, P.L. 99-514, Section 501; 26 U.S.C. § 469. As a result, partnerships, such as the former Debtor in this case, have now largely lost their utility as a method for passive investors to own commercial real estate. Consequently, real estate investment trusts, whose shares are publicly traded, have now largely supplanted limited partnerships as the principal vehicle for passive investors to own interests in commercial real estate, and sound economics, and not tax benefits, are now the primary motivations for investing in commercial real estate. Therefore, single asset real estate cases filed to defer tax liabilities are approaching extinction.

Congressional amendments to the Bankruptcy Code have also reduced the practical importance of the issue of the new value corollary's survival. As exemplified by cases such as *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) the new value corollary often arose in Chapter 11 cases filed to prevent lenders from foreclosing on family farms. Congress responded to the plight of family farmers with legislation. 8 *Collier on Bankruptcy*, ¶1200.01[b] at 1200-2 (15th ed. rev. 1997). In 1986, Congress enacted the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986 which added Chapter 12 to the Bankruptcy Code. Pub. L. 99-554. Unlike Chapter 11, the cramdown provision of Chapter 12, 11 U.S.C. 1225(b) does not require that a plan be "fair and equitable" in order to be confirmed over the objection of an unsecured creditor.

Thus, under a Chapter 12 plan, a family farmer may use future earnings to retain its property over the objection of an unsecured creditor which has not been paid in full. 8 *Collier on Bankruptcy*, ¶1200.01[2] at 1200-4 (15th ed. rev. 1997). As a result of Chapter 12, family farmers no longer need to file Chapter 11 cases in order to save their farms. Therefore, a case such as *Ahlers* is now unlikely to recur.

Because of the foregoing legislative changes, the issue which was important in 1994 when this Court granted certiorari in the *Bonner Mall* case has ceased to be so today.[14] In effect, the foregoing legislative changes which have occurred especially since the *Ahlers* decision, and even since *Bonner Mall*, have transformed cases such as this one into mere historical curiosities which no longer require this Court's attention.

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[14] The continued existence of the new value corollary has certainly stimulated a steady stream of secondary literature. In light of the legislative and economic changes which have diminished the likelihood of future litigation over the existence of the new value corollary, this body of literature is now essentially obsolete.

The Bank's Petition attempts to paint a picture of heated controversy in district and bankruptcy courts over the continued existence of the new value corollary. Petition at 12-13. Even if such a picture was accurate five years ago at the time of the *Bonner Mall* decision, the picture is dramatically different today. In the words of the Bankruptcy Review Commission, which has recommended that Congress codify the new value corollary, "[a] recent trend among bankruptcy and district courts is an almost uniform recognition of the new value exception." Commission Report at 561. Based on the settled state of the law as it exists *today*, the Bank's Petition should be denied.

CONCLUSION

For the reasons set forth above, the Bank's Petition should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Successor by merger to Bank of America Illinois,
Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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REPLY BRIEF FOR PETITIONER

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TABLE OF CONTENTS

Page

REPLY BRIEF FOR PETITIONER 1

CONCLUSION 10

TABLE OF AUTHORITIES

Cases **Page**

Andreuccetti, In re, 975 F.2d 413 (7th Cir. 1992) . . . 5, 8

AOV Indus., In re, 792 F.2d 1140 (D.C. Cir. 1986) 5, 8

Bonner Mall Partnership, In re, 2 F.3d 899 (9th Cir. 1993) 1

Branti v. *Finkel*, 445 U.S. 507 (1980) 7

Bryson Properties, In re, 961 F.2d 496 (4th Cir. 1992) 2

Chateaugay Corp., In re, 10 F.3d 944 (2d Cir. 1993) 8

Coltex Loop Central Three Partners, L.P., In re, No. 96-5140 (2d Cir. Feb. 19, 1998) 1-3

District of Columbia v. *Pace*, 320 U.S. 698 (1944) . . . 7

Exxon Co., U.S.A. v. *Sofec, Inc.*, 116 S. Ct. 1813 (1996) 7

Kansas City Terminal R.R. v. *Central Union Trust Co.*, 271 U.S. 445 (1926) 4

NLRB v. *Hendricks County Rural Elec. Membership Corp.*, 454 U.S. 170 (1981) 7

Northern Pacific R.R. v. *Boyd*, 228 U.S. 482 (1913) 4,10

Northwest Airlines, Inc. v. *County of Kent*, 510 U.S. 355 (1994) 5

Norwest Bank Worthington v. *Ahlers*, 485 U.S. 197 (1988) 1, 3, 4, 9, 10

Pioneer Inv. Servs. Co. v. *Brunswick Assocs. Ltd. Partnership*, 507 U.S. 380 (1993) . . . 7

Stevens v. *Department of Treasury*, 500 U.S. 1 (1991) 4

U.S. Bancorp Mortgage Co. v. *Bonner Mall Partnership*, 513 U.S. 18 (1994) 1-3

United States v. *Johnston*, 268 U.S. 220 (1925) 7

United States v. *Nobles*, 422 U.S. 225 (1975) 7

United States v. *Williams*, 504 U.S. 36 (1992) 4

UNR Indus., Inc., In re, 20 F.3d 766 (7th Cir. 1994) 10

Virginia Bankshares, Inc. v. *Sandberg*, 501 U.S. 1083 (1991) 4

Statute

11 U.S.C. § 1121(b) 9

Miscellaneous

Trost, J. Ronald, et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595 (1997) 3

REPLY BRIEF FOR PETITIONER

Nothing in the brief in opposition undermines the central points in the petition: courts are deeply divided on whether the Bankruptcy Code contains a new value exception to the absolute priority rule; the issue is of enormous practical significance in Chapter 11 cases; and a new value exception is inconsistent with the text and policies of the Bankruptcy Code. The debtor's submission does not even attempt to defend the reasoning of the panel majority. Instead, its primary thrust is that, for various reasons, this case is not an "appropriate vehicle" for addressing the existence or scope of a new value exception. Opp. 9-24. The Seventh Circuit, however, rejected all of those extraneous contentions and instead ruled directly on the question presented in the petition. As a result, this case squarely presents the issue whether there is a new value exception to the absolute priority rule, a question this Court left open in *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 203 n.3 (1988), and *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 513 U.S. 18, 20 n.1 (1994).

1. The debtor makes a half-hearted attempt to argue that there is no circuit split concerning the existence of a new value exception. Opp. 25-27. The suggestion that courts are really in agreement on this issue will surely come as a surprise to the countless judges and commentators who have recognized the sharp divisions and contentious debate that the new value exception has engendered. See Pet. 10-15. The debtor's position is also impossible to reconcile with the Second Circuit's decision in *In re Coltex Loop Central Three Partners, L.P.*, No. 96-5140, slip op. 7-8 (2d Cir. Feb. 19, 1998), which explicitly refused to follow the Seventh Circuit's decision here and the Ninth Circuit's decision in *In re Bonner Mall Partnership*, 2 F.3d 899 (1993), because "[w]e find the reasoning of the dissent in *LaSalle* * * * and the Fourth Circuit in [*In re*] *Bryson* [*Properties*, 961 F.2d 496 (1992)] * * * persuasive."

Moreover, the debtor misreads *Coltex* and *Bryson* in asserting that those decisions turned on whether "the proposed contributions of new capital had * * * been tested by the marketplace to determine whether those contributions were reasonably equivalent to the value of the interests to be retained by the old equity holders." Opp. 27. Both courts made clear that the feature of the proposed plans that violated the absolute priority rule was not the market value of the proposed contributions, but the exclusive opportunity given to prior equity holders — and no one else — to become post-petition owners of the reorganized debtor. *Bryson*, 961 F.2d at 504 (the "exclusive right to contribute constitutes 'property' * * * which was received or retained on account of a prior interest"); *Coltex*, slip op. 8-9 ("the *exclusive* right to retain the debtor's property upon making a capital contribution is itself property" that is received "on account of [the former equity holders'] former interest"). The plans at issue here and in *Bonner Mall* also gave prior equity holders the exclusive right to contribute new capital, but the Seventh and Ninth Circuits upheld confirmation of those plans, because of the new value exception. The conflict could not be more stark. The Second and Fourth Circuits would not "have confirmed the Debtor's Plan" in this case (Opp. 27) — they have held unequivocally that plans giving prior equity owners the exclusive opportunity to receive or retain an ownership interest in a reorganized debtor violate the absolute priority rule when creditors are not paid in full.

2. The conflict is also important. Most new value plans are structured just like this one: they give the prior equity holders the exclusive opportunity to contribute new capital and retain an ownership interest in the reorganized business. Pet. 11. And the negotiations that resolve most Chapter 11 proceedings will be significantly affected by even the *possibility* that a debtor will propose, and a bankruptcy court will confirm, a new value plan. Pet. 16-18. Continued uncertainty as to the existence or scope of a new value exception also drives up the cost of credit for borrowers — a point made forcefully in the *amicus* brief filed in support of the petition by the American Council of Life Insurance (at 2, 8-9).

The debtor does not take issue with any of this. Instead, it asserts that, because of two 1986 statutes, new value plans are "mere historical curiosities" that are "approaching extinction." Opp. 28-29. The debtor is wrong. Judicial and academic debate over the new value exception continues to flourish (Pet. 13-16, 25 n.12), as exemplified by the *Coltex* decision rendered just four days before the certiorari petition was filed. *Amicus* interest in the issue also continues to run high — undoubtedly because, as one recent study indicates, the confirmation prospects for new value plans have, in fact, *improved* considerably in recent years. See J. Ronald Trost, et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595, 644 (1997) (available on Westlaw) ("Seven of the ten reported decisions since *Ahlers* [in 1988] which have actually confirmed new value plans without being subsequently reversed or vacated have been rendered since the beginning of 1995."). The increasing use of new value plans and the deepening division in the circuits combine to make the need for review by this Court even more urgent now than four years ago, when the Court granted certiorari to consider the issue in *Bonner Mall*.

The two pre-*Ahlers* statutes that the debtor cites do not support its contention that controversy over the new value exception will dissipate. Those statutes — one dealing with the taxation of real estate partnerships, the other dealing with farmer bankruptcies — hardly cover the entire range of cases in which the issue arises. Indeed, controversies over the absolute priority rule and its exceptions date back to such railroad cases as *Northern Pacific R.R.* v. *Boyd*, 228 U.S. 482 (1913), and *Kansas City Terminal R.R.* v. *Central Union*

Trust Co., 271 U.S. 445 (1926). Though it is true that real estate cases have provided a disproportionate number of the post-*Ahlers* controversies, they are hardly the only cases in which the issue can arise; as demonstrated in the petition, the issue has the potential of arising in all Chapter 11 cases involving an insolvent debtor — that is, in almost *every* Chapter 11 case. In any event, every one of those real estate controversies was litigated *after* passage of the statute the debtor cites, and they continue to be litigated today. The debtor's speculation that they will suddenly abate because of 12-year-old changes in the tax code is groundless.

3. Most of the brief in opposition (at 9-24) is devoted to arguing that the Seventh Circuit never should have reached the new value issue, because there are other grounds on which the debtor believes it should have prevailed. Even if those separate contentions had any merit — which they do not, as we explain below — they do not provide any reason to deny certiorari. The Court has long followed the rule that it is free to rule on a question as long as the court of appeals actually "'decided the substantive issue presented.'" *United States* v. *Williams*, 504 U.S. 36, 41 (1992) (quoting *Stevens* v. *Department of Treasury*, 500 U.S. 1, 8 (1991)). "'It suffices for our purposes that the court below passed on the issue presented.'" *Ibid.* (quoting *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1099 n.8 (1991)).

Thus, it does not matter whether "[t]his case *should* * * * have spawned any appellate decisions on the new value corollary." Opp. 9 (emphasis added). Because the Seventh Circuit *did* issue a decision on the new value exception, that ruling is reviewable by this Court.

4. The debtor concedes, as it must, that this case is not moot under Article III. Opp. 9 n.5. Instead, although it did not file a cross-petition, it argues that the Seventh Circuit's

judgment should have been dismissal of the Bank's appeal.[1] The debtor contends that it was imprudent for the Seventh Circuit to address the existence and scope of a new value exception in this case, because reversing the confirmation order would harm the pre-petition equity holders who contributed new capital under the plan of reorganization. Opp. 9-15.

The debtor acknowledged in the Seventh Circuit that whether to dismiss a bankruptcy appeal on prudential grounds "turns on the facts of each case." Appellee's Mem. in Support of Mot. to Dismiss, at 6.[2] The courts below examined the pertinent facts of this case, and each found that the plan could be overturned without causing harm to the debtor's investors:

- The bankruptcy court was initially "inclined to grant [a] stay" pending appeal, Tr. Dec. 4, 1995, at 7-8, but ultimately denied a stay

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[1] Because acceptance of the debtor's mootness argument would have led the Seventh Circuit to dismiss the appeal rather than adjudicate the merits, the debtor is seeking to alter the judgment below. In such circumstances, a cross-petition is necessary. *Northwest Airlines, Inc.* v. *County of Kent*, 510 U.S. 355, 364 (1994). Although jurisdictional issues generally may be raised at any time, the debtor concedes that its "mootness" argument is *not* one of jurisdiction, merely one of equity.

[2] See also, *e.g.*, *In re AOV Indus.*, 792 F.2d 1140, 1147-1148 (D.C. Cir. 1986) (deciding whether to dismiss an appeal due to "common sense or equitable considerations * * * require[s] a case-by-case judgment regarding[ ] the feasibility or futility of effective relief should a litigant prevail"); *In re Andreuccetti*, 975 F.2d 413, 418 (7th Cir. 1992) ("determining whether an appeal has become moot requires a fact-specific inquiry into the nature of the relief sought, and the effects that relief could have on the overall reorganization plan").

because "the effect of the confirmation can be fairly easily undone simply by the bank repaying to [the debtor's] investors the amount of their cash contributions," Tr. Dec. 5, 1995, at 14-15. The court reasoned that (a) this is, in essence, a "single asset real estate case," (b) the "main thrust of this plan" is "the restructuring of the financing relationship between the [debtor] and the bank," and (c) "I frankly don't see why that can't be undone in the event that the confirmation is overturned." *Id.* at 17-18.

- The district court agreed. Noting that "[t]he Confirmation Order does not involve complex transactions," the district court declined to dismiss the appeal of the confirmation order because, "in the event of reversal, the implementation of the Plan can be undone without undue difficulty and without harm to third parties." Pet. App. 60a.

- The Seventh Circuit unanimously came to the same conclusion. The court held that "[m]any of the transactions that have occurred to date easily can be reversed without significant harm to third parties" and that "if we were to reverse * * * the bankruptcy court could fashion some form of relief that would not unduly burden innocent third parties." Pet. App. 10a-11a.

These conclusions could be overturned only if the factual findings on which they are based are clearly erroneous. But this Court "do[es] not grant a certiorari to review evidence and discuss specific facts." *United States* v. *Johnston*, 268 U.S. 220, 227 (1925) (Holmes, J.). Moreover, except in "the most exceptional circumstances," this Court has a "settled practice" of "declin[ing] to review" factual findings when "the district court and the court of appeals have

concurred" in those findings. *Branti* v. *Finkel*, 445 U.S. 507, 512 n.6 (1980); accord, *e.g.*, *Exxon Co., U.S.A.* v. *Sofec, Inc.*, 116 S. Ct. 1813, 1819 (1996). That principle has even more force here — *three* levels of the judiciary have reviewed the record and agreed unanimously that the Bank could obtain effective relief should it ultimately prevail. *Pioneer Inv. Servs. Co.* v. *Brunswick Assocs. Ltd. Partnership*, 507 U.S. 380, 397 (1993) (the Court is not "inclined in any event to unsettle factual findings entered by a Bankruptcy Court and affirmed by both the District Court and Court of Appeals").

As a result, the debtor's arguments concerning the ability of the bankruptcy court to fashion effective relief are "not * * * worthy of consideration." *United States* v. *Nobles*, 422 U.S. 225, 241 n.16 (1975) ("declin[ing] to entertain" an evidentiary argument proffered as an alternative ground for affirmance). See also, *e.g.*, *District of Columbia* v. *Pace*, 320 U.S. 698, 700 (1944) ("[w]e did not take this case to determine" a factual question on which "a decision either way would be supported by substantial evidence"; the Court limited its review to a pure legal issue); *NLRB* v. *Hendricks County Rural Elec. Membership Corp.*, 454 U.S. 170, 176 n.8 (1981) (dismissing, as improvidently granted, a cross-petition that "presented primarily * * * a question of fact, which does not merit Court review").[3]

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[3] At all events, the unanimous findings by the courts below are amply supported in the record. The only "third parties" (Opp. 9) the debtor identifies — its own pre-petition investors — will not be harmed if the plan is overturned. Most significantly, the debtor does not cite, and never offered below, *any evidence* that its investors "irretrievably lost the opportunity to engage in a tax free exchange" of property as a result of the unstayed "consummation" of the Plan. Opp. 14 & n.8. In fact, the debtor's own witness

(continued...)

Finally, the debtor's contention that "[t]he very consideration of this case on its merits will cast doubt on the finality of confirmation orders" generally (Opp. 10) is preposterous. The practical effect of the debtor's position, if accepted, would be that no unstayed confirmation order, regardless of the underlying circumstances, could ever be appealed. That has never been the law. Moreover, it is not at all uncommon for courts to rule on the merits of a particular case after deciding that it is not appropriate to dismiss on equitable grounds all or part of an appeal from a confirmation order. *E.g.*, *In re Chateaugay Corp.*, 10 F.3d 944, 952-961 (2d Cir. 1993); *Andreuccetti*, 975 F.2d at 418-421; *AOV*, 792 F.2d at 1148-1154. And the debtor's reliance on Judge Easterbrook's views in making this argument (see Opp. 12) is ironic. Judge Easterbrook voted to grant rehearing *en banc* in this case (Pet. App. 49a), despite the debtor's argument that the case should be dismissed on prudential grounds.

5. The Bank's decision not to appeal the denial of its motion to terminate exclusivity (Opp. 15-17) has nothing to do with the new value issue presented here. Exclusivity refers to a debtor's exclusive right to *file* a proposed plan of

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[3] (...continued)
testified that the debtor's pre-petition partners could still offset their gains by investing in other loss-generating ventures. Tr. Dec. 5, 1995, pp. 21-29. Moreover, in its unsuccessful attempts to obtain a stay pending appeal, the Bank offered to repay the investors with interest, to "post a bond," and to use the value of its secured interest in the property to fund any shortfalls that the debtor might experience if confirmation of the plan were stayed pending appeal. Pet. App. 10a-11a; Tr. Dec. 6, 1995, pp. 17-21, 44-46. The district court thought the Bank was "offering too much," Tr. Dec. 6, 1995, p. 19, and ultimately refused to dismiss the appeal because overturning the plan would not cause "harm to third parties." Pet. App. 60a.

reorganization during the first 120 days of the Chapter 11 proceeding. 11 U.S.C. § 1121(b). Whether there is a new value exception, on the other hand, goes to whether a plan — regardless of who proposed it — may be *confirmed*. Our argument is that the *substance* of the plan here violated the absolute priority rule because it provided that only pre-petition equity holders had the opportunity to be owners of the reorganized debtor. We do not contend that the bankruptcy court violated the absolute priority rule when it denied the Bank the opportunity to file a competing plan.

6. The debtor also asserts that the absolute priority rule is not violated here, because its investors' post-petition equity interests are "worthless" and thus are not "'property' which would have been available to satisfy creditors' claims." Opp. 17. That argument is foreclosed by *Ahlers*. The Court there specifically rejected the contention that the absolute priority rule does not apply when the equity interest in the debtor is "worthless" and "has no value to the senior unsecured creditors." 485 U.S. at 207. The Court explained:

> Even where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains "property." Whether the value is "present or prospective, * * * or only for purposes of control" a retained equity interest is a property interest to "which the creditors [are] entitled * * * before the stockholders [can] retain it for any purpose whatever."

Id. at 207-208 (quoting *Boyd*, 228 U.S. at 508).

Indeed, the fact that the pre-petition equity holders have "valueless partnership interests" in the debtor (Opp. 19) illustrates one of the many vices inherent in the new value exception. The new value plan here prevents the Bank from foreclosing, and thus limits the Bank's recovery to only 16% of the present value of its $38 million unsecured claim, Pet.

App. 28a, 133a — in order to perpetuate the existence of a debtor that is "worthless in a balance sheet sense." Opp. 19. This is inconsistent with the animating purpose behind Chapter 11; creditors of insolvent debtors are supposed to be in the driver's seat, not prior equity holders. *Ahlers*, 485 U.S. at 207. Chapter 11 was intended to "enabl[e] business operations that have *positive* value to carry on." *In re UNR Indus., Inc.*, 20 F.3d 766, 771 (7th Cir. 1994) (emphasis added). It was not designed to permit "valueless" (Opp. 19) business enterprises to continue in operation while the claims of senior creditors are unpaid.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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No. 97-1418

In The

Supreme Court of the United States

October Term, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Successor by merger to Bank of America Illinois,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE AND BRIEF OF THE AMERICAN COLLEGE OF REAL ESTATE LAWYERS AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

The American College of Real Estate Lawyers ("ACREL") by and through their undersigned attorney hereby respectfully moves this Court for leave to file the attached amicus curiae brief in support of the Petitioner in the above captioned matter (the "Appeal") and respectfully represent as follows:

Consent of Parties

The consent of the attorney for the Petitioner has been obtained. The consent of the attorney for the Respondent was requested but refused.

Interest of the Amicus Curiae

I. ACREL is a non-profit corporation organized for the purpose of gathering together lawyers to improve and reform real estate law. ACREL's membership consists of over 800 attorneys from nearly every state and the District of Columbia, all of whom have concentrated their practice in real estate law for a period of ten years or more, and law professors specializing in the field of real estate law. The case at bar involves a single asset debtor owning commercial real estate.

II. ACREL believes that the decision of the Seventh Circuit, if upheld, will have a serious adverse affect on the availability of financing for the acquisition and development of commercial real property in the United States.

III. ACREL therefore has an interest in presenting to the Court the view that in the broad context of public

policy and future economic development and growth, the interpretation of the Bankruptcy Code advanced by the Seventh Circuit is erroneous and certiorari should be granted to review that interpretation.

The Proposed Amicus Curiae Brief

IV. A copy of the proposed amicus curiae brief is submitted herewith. The proposed brief focuses on legal and policy arguments not made in the brief of the Petitioner.

Conclusion

Due to the Amicus' substantial interest in the outcome of the Appeal, due to the Amicus' substantial expertise in the real estate issues involved in the Appeal, and due to the importance of the issues presented, the *Amicus* hereby requests that its motion for leave to file and *amicus curiae* brief in the Appeal be granted.

Dated: Jamaica, New York
March 31, 1998

Respectfully submitted,

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QUESTIONS PRESENTED

1. Whether the "new value exception" to the "absolute priority rule" survived the codification of a modified absolute priority rule under § 1129(b)(2)(B)(ii) of the Bankruptcy Code, which does not reflect such an exception.

2. Assuming, arguendo, the existence of a "new value exception" as articulated by this Court in *dicta* in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), whether the Seventh Circuit properly applied the exception.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

STATEMENT OF INTEREST OF AMICUS CURIAE ... 1

SUMMARY OF ARGUMENT 2

ARGUMENT 3

I. THE SO-CALLED NEW VALUE EXCEPTION OR NEW VALUE COROLLARY WAS NOT INCORPORATED INTO THE BANKRUPTCY CODE 3

A. Confirmation of New Value Plans Prior to the Adoption of the Bankruptcy Code Is an Illusion 3

B. Congress Rejected the New Value Exception When Adopting the Bankruptcy Code 4

II. THE NEW VALUE EXCEPTION AS ADOPTED BY THE SEVENTH CIRCUIT DISTORTS THE NEW VALUE COROLLARY AS ARTICULATED IN *DICTA* BY THIS COURT AND ABROGATES THE ABSOLUTE PRIORITY REQUIREMENTS OF THE BANKRUPTCY CODE 7

A. The Seventh Circuit Ignores the Creditor Protection Prong of this Court's Articulation of the New Value Requirements 7

B. The Seventh Circuit Distorts the Prerequisites to New Value Articulated by this Court in *Case* 9

TABLE OF CONTENTS – Continued

Page

1. Necessity 10

2. Reasonable Equivalence 11

III. THE APPLICATION OF THE SEVENTH CIRCUIT'S VISION OF NEW VALUE TO SINGLE ASSET REAL ESTATE REORGANIZATIONS WOULD SERVE NO PUBLIC PURPOSE, ABROGATE THE PROTECTION FOR MORTGAGEES BUILT INTO THE BANKRUPTCY CODE, AND HAVE A SEVERE AND NEGATIVE IMPACT ON BORROWERS, LENDERS, AND THE REAL ESTATE INDUSTRY 13

A. No Public Purpose 13

B. Abrogation of Mortgagee Protection 14

C. Negative Impact on the Real Estate Industry 17

TABLE OF AUTHORITIES

Page

CASES

Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) 4, 5, 7, 8, 9

Dewsnup v. Timm, 502 U.S. 410 (1992) 6

In re 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997) ..... *passim*

In re 203 N. LaSalle St. Partnership, 190 B.R. 567 (Bakr. N.D. Ill. 1995) 6, 10, 12, 16, 17

In re Coltrex Loop Central Three Partners, L.P., No. 96-5140, slip op. 7-17 (2d Cir. Feb. 19, 1988) 3

In re DRW Property Co. 82, 57 B.R. 987 (Bankr. N.D. Tex. 1986) 15

In re Pine Gate Associates, Ltd., 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976) 14, 15

In re Snyder, 967 F.2d 1126 (7th Cir. 1992) 9

In re Woodbrook Associates, 19 F.3d 312 (7th Cir. 1994) 10

Kansas City Terminal Ry. Co. v. Central Union Trust Co., 271 U.S. 445 (1926) 8, 9

Northern Pacific Ry. v. Boyd, 228 U.S. 482 (1913) 11

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 11, 12

STATUTES

11 U.S.C. § 506(a) 16

11 U.S.C. § 1111(b) 15

11 U.S.C. § 1129(b)(2) 16

TABLE OF AUTHORITIES – Continued

Page

11 U.S.C. § 1129(b)(2)(B) 6, 14

48 Stat. 912 (Bankruptcy Act of 1898 § 77B) 7

MISCELLANEOUS

John D. Ayer, Rethinking *Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963 (1989) 4

Bruce Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69 (1991) 4

Hearings on S.2266 and H.R. 8200 before the Subcomm. on Improvements in the Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong., 853 (1977) (statement of John J. Creedon, American Council of Life Insurance) 14

5 COLLIER ON BANKRUPTCY ¶ 506.03 [4][e], at n.58 (Lawrence P. King et al. eds. 15th ed. rev. 1997) 16

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, Part I, 93d Cong. 1st Sess. (1973), at 256-57 ..... 4, 5

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, Part II, 93d Cong. 1st Sess. (1973), at 242, § 7-303(4) 4, 5

S. Rep. No. 95-598, 95th Cong. 2d Sess. 65 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787 15

STATEMENT OF INTEREST OF AMICUS CURIAE[1]

The American College of Real Estate Lawyers ("ACREL") is a nonprofit corporation organized for the purpose of, *inter alia*, gathering together lawyers "to improve and reform real estate law and practice," (ACREL Articles of Incorporation at 2). ACREL's membership consists of over 800 attorneys from nearly every state and the District of Columbia who have concentrated their practice in real estate law for a period of ten years or more, and law school professors specializing in the field of real estate law. In addition, members elected to ACREL must have demonstrated a willingness to devote time to improving real property law through writing, teaching or participation in professional association activities. ACREL's membership represents the entire spectrum of the real estate industry including borrowers, lenders, investors and developers. The case at bar involves a debtor whose single asset is an interest in commercial real estate that has declined in value to a point where the debtor's real estate is worth less than the amount of secured debt on the property. Whether the property securing the debt may be retained by the debtor's partners under a new value plan without paying the debt is an issue of significant concern to the real estate industry.

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[1] Counsel for a party did not author this brief in whole or in part. No person or entity, other than the Amicus Curiae, its members, or its counsel made a monetary contribution to the preparation and submission of this brief.

This brief supports the petition of the Petitioner in this case. Due to the background of the Amicus, its experience as counsel to lenders and borrowers, and its familiarity with the confusion, costs and consequences to the real estate industry arising from the ambiguities created by the issues before this Court, ACREL is in a unique position to offer its expertise concerning the adverse consequences that would result from the decision below on the availability of financing for the acquisition and development of commercial real property in the United States.

SUMMARY OF ARGUMENT

This brief urges that certiorari be granted for the following reasons:

1. There is no new value exception or corollary to the fair and equitable requirement of the Bankruptcy Code. The new value principle as articulated in *dicta* prior to the adoption of the Bankruptcy Code was rejected by Congress in favor of a more flexible and modified absolute priority rule that obviated the need for a new value principle.

2. The new value exception applied by the Seventh Circuit distorts the new value corollary articulated by this Court in its *Case v. Los Angeles Lumber dicta* and represents a post-Code invention that contravenes the parameters set by Justice Douglas in *Case* and threatens the very existence of the absolute priority rule.

3. The Seventh Circuit's decision undermines the protection for real estate mortgages built into the Bankruptcy Code and threatens to have a severe negative impact on the real estate industry and the availablity of real estate mortgage financing.

ARGUMENT

I. THE SO-CALLED NEW VALUE EXCEPTION OR NEW VALUE COROLLARY WAS NOT INCORPORATED INTO THE BANKRUPTCY CODE.

This brief supports the conclusions and reasoning of the brief of the Petitioner, the dissent of Judge Kanne in the Seventh Circuit's opinion in *In re 203 N. LaSalle St. Partnership*, 126 F.3d 955, 970 (7th Cir. 1997) and the opinion of the Second Circuit in *In re Coltex Loop Central Three Partners, L.P.*, No. 96-5140, slip op. 7-17 (2d Cir. Feb. 19, 1998) that there is no hold-over new value exception or corollary to the absolute priority rule of the Bankruptcy Code.

A. Confirmation of New Value Plans Prior to the Adoption of The Bankruptcy Code Is an Illusion.

The Seventh Circuit stated that "the new value corollary has long been ensconced in our bankruptcy practice," *In re 203 N. LaSalle St. Partnership*, 126 F.3d 955, 965 (7th Cir. 1997), and that it has been "a major source of new funding in reorganizations for the past fifty years."

Id. at 966. From this predicate, the Seventh Circuit concluded that "one would expect that Congress would address deliberately such a significant issue of economic policy if it had determined to abolish it." *Id.* The problem with this conclusion is that its predicate is incorrect.

From the decision of this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), to the adoption of the Bankruptcy Code in 1978, there appears to be no published evidence that any "shareholder was ever able to convince a court that she contributed sufficient value to be able to retain an interest. Indeed, until the Code's adoption in 1978, no reported case seems to have adopted Justice Douglas' *dicta* as its holding." Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 93 (1991); *see also*, John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963, 1016 (1989) where Professor Ayer concludes, "Justice Douglas' supposed 'exception,' . . . is nowhere present as a rule of decision in Chapter X cases. New value under Chapter X, then, is an illusion."

Thus there was no 50 year history of the new value exception being part of bankruptcy "practice." While the new value theory, as expressed in *dicta* by this Court in *Case* was known, that theory never became part of bankruptcy practice until after the adoption of the Bankruptcy Code.

B. Congress Rejected the New Value Exception When Adopting the Bankruptcy Code.

In 1973, the Commission on the Bankruptcy Laws of the United States in its Report, H.R. Doc. No. 93-137,

Parts I & II, 93d Cong. 1st Sess. (1973), concluded that the absolute priority rule had become a "strait jacket" (Part I at 256-57) because, as applied, it did not permit old equity to participate even with the agreement of all classes of creditors. Its solution was to modify the absolute priority rule by permitting juniors to participate on the basis of a contribution "important to the operation of the reorganized debtor . . . under the plan" on a basis reasonably approximating the value of their contribution. H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. (1973) at 242, § 7-303(4). This proposal created a storm of criticism and was rejected by Congress.

In its place, Congress modified the absolute priority rule to limit its application only to dissenting impaired classes of creditors, thus breaking the perceived strait-jacket by freeing classes of creditors to admit junior interests by agreement. If this limited absolute priority had been in effect under the Bankruptcy Act, the *Case* plan would have been confirmed and the issue that gave rise to the creation of the new value corollary would never have arisen. Thus the Bankruptcy Code obviated the need for a new value corollary. The dissent in LaSalle noted, "the pre-Code rationale for the new value exception makes little sense in today's Chapter 11 environment." 126 F.3d at 976.

Indeed Congress considered a provision that would have incorporated new value into the Code (even including, it would seem, alternative forms of contribution, such as were proffered in *Case*), rejected it and enacted a compromise that allowed for participation by agreement. Although those arguing that the new value corollary survived the adoption of the Bankruptcy Code do so on

the basis that "Congress . . . does not write 'on a clean slate.' " *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992), the facts would seem to indicate either that there was nothing on Congress's slate when the Bankruptcy Code was being considered or, if the new value principle were on its slate, Congress clearly erased it before it began to write.

The clear language of Bankruptcy Code § 1129(b)(2)(B) prohibits juniors from retaining an interest on account of their junior interest if dissenting creditors are unpaid. Proponents of new value argue that the interest is not being retained "on account of" the junior interest but because the debtor has made a bid in the form of new value. *LaSalle*, 126 F.3d at 964. It stretches credulity to believe that the debtor, in control of all the information about the property and with the exclusive right to present a plan, is not retaining an interest on account of its junior interest. Indeed in *LaSalle* the Bankruptcy Court argued that the new value offered did not represent the intrinsic value of the property but rather was based on the partners' need to retain the property to avoid tax consequences arising out of their prior interest in the property, thus acknowledging that the new value was offered, and the property retained, on account of the prior junior interest. *See In re 203 N. LaSalle St. Partnership*, 190 B.R. 567, 576 (Bankr. N.D.Ill. 1996); and *infra* note 6.

II. THE NEW VALUE EXCEPTION AS ADOPTED BY THE SEVENTH CIRCUIT DISTORTS THE NEW VALUE COROLLARY AS ARTICULATED IN *DICTA* BY THIS COURT AND ABROGATES THE ABSOLUTE PRIORITY REQUIREMENTS OF THE BANKRUPTCY CODE.

A. The Seventh Circuit Ignores the Creditor Protection Prong of this Court's Articulation of the New Value Requirements.

As discussed above, this brief argues that no new value principle survived the adoption of the Bankruptcy Code. Even if this Court should conclude that new value is still viable, certiorari should be granted and the Seventh Circuit should be reversed because the supposed "new value corollary" applied is not the corollary to absolute priority articulated by this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939).

In *Case*, this Court struck down a plan under which old equity[2] attempted to circumvent the requirement that a plan had to be "fair and equitable," which term requires that interests in the debtor be distributed on the basis of "absolute priority." 308 U.S. at 106. The *Case* plan, approved by all classes of creditors, would have allowed old equity to retain an interest in the debtor based on a promised contribution of expertise even though creditors were not fully compensated.[3] In *dicta*, this Court noted

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[2] The term "old equity" as used herein refers to the stockholders, partners or principals of the debtor.

[3] *Case* was decided under § 77B of the Bankruptcy Act of 1898 (48 Stat. 912). Had the Bankruptcy Code been in effect at the time, the *Case* plan would have been confirmed. Under the

that it had previously stated that creditors could be protected "through other arrangements *which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor.*" 308 U.S. at 117 (quoting *Kansas City Terminal Ry Co. v. Central Union Trust Co.*, 271 U.S. 445, 454 (1926)) (emphasis added). Justice Douglas stated that where the *necessity* for funds exists and old equity makes a fresh contribution "and receive[s] in return a participation *reasonably equivalent* to their contribution," the creditors cannot object on the ground that they were not accorded their "full right of priority against the corporate assets." *Id.*

The *dicta* in *Case* permitted old equity to obtain an interest in the debtor *only if* creditors were accorded their "full right of priority" against the debtor's assets. Old equity could not participate "at the expense of the prior rights . . . of creditors." 308 U.S. at 116. It is this creditor protection prong of the *Case dicta* that the Seventh Circuit and cases adhering to its view, ignore. In *LaSalle*, old equity was allowed to retain valuable property at the expense of the unpaid mortgagee, which received only 16% on its deficiency claim. This would hardly seem to accord the creditor its "full right of priority."[4]

Bankruptcy Code, the fair and equitable requirement applies only to dissenting impaired classes of creditors. Thus there was no longer a need for a "new value corollary" to permit uncompensated seniors to admit juniors, which was the issue in *Case*.

[4] How the standards of the *Case* dicta can be achieved has been the source of much controversy. This difficulty may be the basis for the apparent lack of any reported cases under which a court confirmed a new value plan over the objection of a

Thus, by not affording the creditor its full right of priority, the *LaSalle* debtor's plan did not meet the requirements of the new value corollary to the absolute priority rule, was not fair and equitable, and should not have been confirmed over the objection of an impaired class of creditors. Although the Seventh Circuit refers to new value as a "corollary" to the absolute priority rule, its decision converts the *Case* corollary to a wide exception to the rule that threatens to consume the rule itself. We respectfully urge that certiorari be granted to resolve the extent of protection afforded by the absolute priority rule of the Bankruptcy Code under a new value plan.

B. The Seventh Circuit Distorts the Prerequisites to New Value Articulated by this Court in *Case*.

Under the *dicta* in *Case*, a plan in which old equity retains an interest might be confirmed upon a contribution of new value in the form of money or money's worth *only if* the full priority rights of creditors are preserved; *if* the new value is necessary or " *'essential to the success of the undertaking,'* " 308 U.S. at 121 (quoting *Kansas City Terminal Ry.*, 271 U.S. at 454) (emphasis added); *and if* the retained interest is *reasonably equivalent* to old equity's contribution.[5]

---

creditor prior to the adoption of the Bankruptcy Code. This difficulty may also explain the abrogation by some courts (presumably unwittingly) of the creditor protection prong of this Court's articulation of the new value principle.

[5] The courts have engrafted to the *Case* requirements, a further prerequisite of substantiality as either a corollary to the requirement of necessity (*In re Snyder*, 967 F.2d 1126, 1131 (7th

In *LaSalle*, the requirements of necessity and reasonable equivalence have been so ignored and distorted that in reality they no longer are prerequisites to confirmation of a new value plan.

(1) *Necessity*. When Justice Douglas referred to the "necessity, at times, of seeking new money 'essential to the success of the undertaking,' " *id.*, he obviously was referring to the necessity for funds to continue the operation of the enterprise, the production of its product, the provision of its services, and the employment of its workers. In single asset real estate cases, it is normally difficult to find this necessity. There is no business to be continued, no product to be produced, and no service to be performed that will not be continued, produced or performed by the new owner of the real estate.

Cir. 1992)) or as a substitute for all other factors. The substitute theory can be seen in the bankruptcy court decision in *LaSalle*, where the court sees an implication in *In re Woodbrook Associates*, 19 F.3d 312, 320 (7th Cir. 1994) that "substantiality serves as something of a summary of the other factors" (*In re 203 N. LaSalle Street Ltd. Partnership*, 190 B.R. 567, 586 (Bankr. N.D. Ill. 1995)). All courts seem to agree that there is no mathematical formula for determination of substantiality and that the determination should be based on "common sense." This was the view of the Seventh Circuit in *LaSalle*. 126 F.3d at 967. While the addition of another prerequisite on its face causes no harm, given the enormous flexibility that some courts have allowed themselves in determining whether this requirement has been met, and their apparent conclusion that if this requirement is met there is no need to consider the other prerequisites, it appears that "substantiality" is but another shorthanded way to circumvent this Court's stated conditions for confirmation of new value plans.

Confronted with the fact that funds were not essential to the success of the undertaking in *LaSalle*, the Seventh Circuit distorted the necessity requirement to mean essential for confirmation of the debtor's "plan" ("The infusion of new capital was necessary for the successful implementation of the plan." 126 F.3d at 967). Since new value is always proposed by the debtor to enable old equity to keep the property, this switch in the meaning of "necessary" would result in virtually every new value plan meeting this requirement over dissenting unpaid creditors' objection. The approach taken by the Seventh Circuit effectively reads necessity out of the prerequisites for new value plan confirmation. We urge that certiorari be granted to resolve the meaning of "necessary" or "essential."

2. *Reasonable Equivalence*. Under this prerequisite, old equity may not receive more than the reasonable equivalence of its contribution. In single asset cases, the debtor usually has no equity in the property (the property value is lower than the mortgages encumbering it, as was the case in *LaSalle*). In the past, debtors have argued that retention of the property by old equity does not deprive the creditor of its "full right of priority" because what the debtor proposes to retain is worthless. This Court has clearly rejected this "no-value" argument. In *Northern Pacific Ry. v. Boyd*, 228 U.S. 482, 508 (1913), this Court stated that "control" itself was an asset that constituted value and that such value belonged to the creditors, not old equity. This Court again in 1988 reaffirmed that determination in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), stating that "we join in the consensus of

authority which has rejected this 'no value' theory." *Id.* at 207-08.

Notwithstanding these decisions, the *LaSalle* court employed the no-value theory as the basis for determining whether the contribution met the reasonable equivalence standard. The Bankruptcy Court stated that "the contribution is easily the equivalent of the interests retained by the debtor's partners. Indeed, on the market, those interests are worthless." 190 B.R. at 588. The Seventh Circuit acknowledged that the Bankruptcy Court had determined that the contribution was "reasonably equivalent to the interest retained" but failed to discuss whether the requirement had been met, apparently agreeing with the Bankruptcy Court's determination. 126 F.3d at 967.

While legislative suggestions have been made for dealing with new value, none appear to have addressed solutions to the fundamental issues involving compliance with the holdings of this Court discussed in this part of the brief. It is respectfully urged that if we are to remain subject to the rule of law, certiorari should be granted to undo what appears to be an obvious attempt to evade decisions of this Court.

III. THE APPLICATION OF THE SEVENTH CIRCUIT'S VISION OF NEW VALUE TO SINGLE ASSET REAL ESTATE REORGANIZATIONS WOULD SERVE NO PUBLIC PURPOSE, ABROGATE THE PROTECTION FOR MORTGAGEES BUILT INTO THE BANKRUPTCY CODE, AND HAVE A SEVERE AND NEGATIVE IMPACT ON BORROWERS, LENDERS, AND THE REAL ESTATE INDUSTRY.

A. No Public Purpose.

The confirmation of new value plans is often urged as a matter of public policy on the ground that the funds are needed to keep the debtor in business, preserve the going concern value, keep people employed, and preserve the performance or production of needed services or products. Whether or not such arguments make sense in the case of a manufacturer or service provider, these laudable objectives are wholly inapplicable to single asset real estate cases. In the single asset real estate transaction the operation of the real estate will continue no matter who is the owner of the property. It is a non-sequitur to say that the "reorganization will fail" if there is no infusion of new value. The only thing that may fail is the attempt by old equity to keep the debtor's property without paying its just debts.

If the debtor's plan cannot be confirmed and the property goes to foreclosure, the mortgagee or other purchaser at the sale will operate the property. The question is not whether the business will continue. The question is only who will own the property – the debtor's old equity who have not paid the debtor's obligations to creditors, or the creditors who have not been paid. The decision

below opts for the former with old equity given the property and 84% of the creditors deficiency claim wiped out. No public purpose can be served by such a result.

B. Abrogation of Mortgagee Protection.

Section 1129(b)(2)(B) of the Bankruptcy Code prohibits confirmation of a plan over the objection of an impaired class of unsecured creditors if old equity is permitted to retain an interest in the property on account of its junior interest. A major reason for this provision was to overcome the so-called *Pine Gate* line of cases that treated nonrecourse mortgagees as the Seventh Circuit now treats all mortgagees. In *In re Pine Gate Associates, Ltd.*, 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976), and its progeny, decided under chapter XII of the former Bankruptcy Act, the bankruptcy courts allowed debtors to retain the mortgaged property upon payment to the non-recourse mortgagee of the depressed (due to the mid-70's recession) value of the collateral. In direct response to the perceived inequity of the *Pine Gate* line of cases, Congress was asked to restore absolute priority to real estate arrangements under the new chapter 11 of the Bankruptcy Code. *See, e.g.*, Hearings on S.2266 and H.R. 8200 before the Subcomm. on Improvements in the Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong., 853, 855-56, 864-76 (1977) (statement of John J. Creedon, American Council of Life Insurance).

Congress enacted a package of protection insuring that the mortgagee may have an unsecured claim for the deficiency and providing absolute priority for each dissenting impaired class of creditors, including the

unsecured class. It was this absolute priority for the unsecured class, including the mortgagee's deficiency claim, that provided the protection afforded by Congress. If the unsecured class rejected the plan (and normally in single asset cases the mortgagee's deficiency claim is the only major unsecured claim) the debtor would not be able to retain the property without paying the creditors. The plan could not be confirmed.

New value as applied in *LaSalle* and many post enactment Bankruptcy Code cases would abrogate this protection by restoring the *Pine Gate* rule – in a much more sinister form. In both situations the debtor would keep the property. The difference is that in *Pine Gate*, the mortgagee would receive an immediate payment of cash equal to the court determined value of the collateral whereas in the new value cases after the enactment of the Bankruptcy Code, the mortgagee would receive only a mortgage with a face amount equal to the court determined value of the collateral. This retention of the property by old equity when portions of, or all of the mortgagee's deficiency claim is wiped out is clearly the opposite of what Congress intended. *See* S. Rep. No. 95-598, at 65 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5851 (stating that a precursor of present § 1111(b), which affords a deficiency claim to nonrecourse mortgagees, "answers the nonrecourse loan problem and gives the creditor an unsecured claim for the difference between the value of the collateral and the debt in response to the decision in" *Pine Gate*); *see also In re DRW Property Co. 82*, 57 B.R. 987, 990 (Bankr. N.D. Tex. 1986) (stating Congress enacted section 1111(b) "to alleviate the *Pine Gate* problem and to attempt to restore the benefit of the bargain to nonrecourse secured creditors").

Indeed the statutory language prevents the debtor in single asset cases from ever retaining the property when the mortgagee's deficiency claim is unpaid. Section 506(a) provides that a claim is secured only to the extent of the value of the collateral. Section 1129(b)(2) requires that the secured claim be equal in amount and value to the collateral value as of the effective date of the plan. Any new value offered represents a bid by old equity for the single property in an amount in excess of the amount of the mortgage. Such a bid represents the value of the property and, under § 1129(b)(2), requires that the secured claim be increased to that value. As a result no plan under which the property will be acquired for less than the full amount of the mortgage balance before bifurcation into secured and unsecured portions can be confirmed over the objection of the secured creditor class.[6]

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[6] In *LaSalle*, the Bankruptcy Court attempted to deflect this argument by finding that the bid was not based on the "intrinsic" value of the real estate "but because of the tax consequences that flow from their loss." 190 B.R. at 588. However the price paid for property is normally considered determinative of value without an examination of the motivations of the purchaser. "[I]f the collateral is actually sold during the course of the bankruptcy proceedings or pursuant to a confirmed plan, the consideration received from the sale will almost always resolve the question of value." 5 COLLIER ON BANKRUPTCY ¶ 506.03[4][a] at n.58 (Lawrence P. King et al. eds. 15th ed. rev. 1997). Indeed, in *LaSalle* the bankruptcy court itself, in referring to what would be paid on the deficiency claim, stated that the creditor will receive "50% of the net *value* of the property either as *realized in a sale*, or as appraised at the time of any refinancing." (emphasis added). The price paid indicates value. The motivation of the purchaser is irrelevant.

It should be apparent that new value as interpreted by the Seventh Circuit would undo the absolute priority protection afforded by Congress to mortgagees. This would represent a major change in the treatment of creditors in bankruptcy. We respectfully request that certiorari be granted to resolve this issue.

C. Negative Impact on the Real Estate Industry.

The decision below will have a severe adverse impact on the real estate industry. Literally billions of dollars have been loaned to real estate developers by institutions, including insurance companies and pension plans that insure and protect millions of ordinary citizens, on the strength of real property collateral and the protection for realization on that collateral built into the Bankruptcy Code.

The decision below will result in the reduction of the availabilty of funds for real estate development, as lenders, faced with the uncertainties of the decision below, channel funds away from real estate investments to other forms of lending. For those funds that are available for real estate investment, the decision below will result in tighter credit standards and higher interest rates to reflect the greater risk involved. The failure to resolve the issues raised by *LaSalle* will mean the continuation of the present uncertainty and extensive future litigation in real estate bankruptcies. Thus *LaSalle* not only threatens existing mortgage debt held by lenders, but also threatens the future of the real estate industry, which relies so heavily on mortgage financing.

The Bankruptcy Code was carefully drafted by Congress to balance the interests of debtors and creditors and provide for the efficient administration of bankruptcy cases in the United States. If Courts are permitted by judicial legislation to undermine the foundations of the protection afforded to real estate mortgagees, the real estate industry and the national economy will be severely and adversely affected.

CONCLUSION

For all the reasons set forth herein, the American College of Real Estate Lawyers respectfully urges this Court to grant certiorari.

Respectfully submitted,

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No. 97-1418

IN THE
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OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Petitioner,
v.
203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

Pursuant to Rule 37.2(b) of this Court, the American Council of Life Insurance ("ACLI") respectfully moves this Court for leave to file the accompanying brief *amicus curiae* in support of the Petition for Writ of Certiorari filed by Bank of America National Trust and Savings Association. Petitioner has consented to the filing of this brief, and petitioner's written consent has been filed with the Clerk of the Court. Respondent has refused its consent.

ACLI is the principal national trade association of life insurance companies in the United States. Its members have a significant stake in the resolution of the question presented in this case. Life insurance companies are a major source of investment capital, providing more than ten percent of institutional funds flowing into U.S. finan-

cial markets in 1996 and holding more than $1 trillion in corporate bonds and mortgages as of year-end 1996.

ACLI participated as *amicus curiae* when the question presented in this case was last before the Court four Terms ago in *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, No. 93-714. Although the Court did not reach the merits in that case, ACLI believes that its briefs at the petition stage and on the merits provided the Court with a valuable perspective on the importance of the issue and the proper resolution of the question on the merits. ACLI believes that its views in this case will be equally valuable to the Court.

WHEREFORE, ACLI respectfully requests that the Court grant it leave to file the accompanying brief *amicus curiae* in support of the Petition for Writ of Certiorari.

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF REASONS FOR GRANTING THE WRIT	2
REASONS FOR GRANTING THE WRIT	3
I. THE COURTS OF APPEALS, DISTRICT COURTS, AND BANKRUPTCY COURTS ARE DIVIDED ON WHETHER AN EQUITY-ONLY NEW VALUE RIGHT IS CONSISTENT WITH ABSOLUTE PRIORITY	3
II. THE AVAILABILITY OF AN EQUITY-ONLY NEW VALUE RIGHT IS AN ISSUE OF EXCEPTIONAL IMPORTANCE TO LENDERS AND BUSINESS OWNERS	8
III. THE DECISION OF THE COURT OF APPEALS IS INCONSISTENT WITH THE PLAIN MEANING OF SECTION 1129(b) OF THE BANKRUPTCY CODE, THIS COURT'S JURISPRUDENCE ON THE INTERPRETATION OF THE BANKRUPTCY CODE, AND BANKRUPTCY POLICY	9
CONCLUSION	17

TABLE OF AUTHORITIES

Cases	Page
In re Ahlers, 794 F.2d 388 (8th Cir. 1986), *rev'd on other grounds*, 485 U.S. 197 (1988)	5
In re Ambanc La Mesa Ltd. Partnership, 115 F.3d 650 (9th Cir. 1997), *cert. denied*, 118 S. Ct. 1039 (1998)	7
In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994)	5
In re Bryson Properties, XVIII, 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992)	6, 10
Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939)	*passim*
Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Associates, L.P., 1998 WL 90844 (2d Cir. Feb. 19, 1998)	6
Dewsnup v. Timm, 502 U.S. 410 (1992)	11, 12, 13
In re Greystone III Joint Venture, 995 F.2d 1274 (5th Cir. 1991), *withdrawn in part*, 995 F.2d at 1284 (5th Cir.), *cert. denied*, 506 U.S. 821 (1992)	6
In re Homestead Partners, Ltd., 197 B.R. 706 (Bankr. N.D. Ga. 1996)	7
Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351 (7th Cir. 1990)	4, 16
In re Mallard Associates, 475 F. Supp. 1045 (S.D.N.Y. 1979)	15
Marine Harbor Properties, Inc. v. Manufacturer's Trust Co., 317 U.S. 78 (1942)	12
In re Moonraker Associates, Ltd., 200 B.R. 950 (Bankr. N.D. Ga. 1996)	7
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988)	*passim*
Pennsylvania Department of Public Welfare v. Davenport, 495 U.S. 552 (1990)	13
SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965)	15
In re Snyder, 967 F.2d 1126 (7th Cir. 1992)	4
In re Tallahassee Associates, L.P., 132 B.R. 712 (Bankr. W.D. Pa. 1991)	7

TABLE OF AUTHORITIES—Continued

	Page
Toibb v. Radloff, 501 U.S. 157 (1991)	11
U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 513 U.S. 18 (1994)	3, 4, 8
In re U.S. Truck Co., 800 F.2d 581 (6th Cir. 1986)	6
Union Bank v. Wolas, 502 U.S. 151 (1991)	13
United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989)	11, 13
In re VIP Motor Lodge, Inc., 133 B.R. 41 (Bankr. D. Del. 1991)	7
In re Winters, 99 B.R. 658 (Bankr. W.D. Pa. 1989)	7
Statutes	
Act of June 7, 1934, ch. 424, sec. 1, § 77B(f), 48 Stat. 911, 919 (superseded 1938)	12
Bankruptcy Act of 1898 (formerly codified at 11 U.S.C. § 1 et seq. (repealed 1979))	*passim*
Bankruptcy Reform Act of 1978, 11 U.S.C. § 101 et seq.	*passim*
11 U.S.C. § 556 (repealed 1979)	14
11 U.S.C. § 569 (repealed 1979)	14
11 U.S.C. § 621(2) (repealed 1979)	12
11 U.S.C. § 706(1) (repealed 1979)	14
11 U.S.C. § 723 (repealed 1979)	14
11 U.S.C. § 742 (repealed 1979)	14
11 U.S.C. § 823 (repealed 1979)	14
11 U.S.C. § 844 (repealed 1979)	14
11 U.S.C. § 1104(a)	14
11 U.S.C. § 1107(a)	14
11 U.S.C. § 1121	5, 15
11 U.S.C. § 1129(a)	15
11 U.S.C. § 1129(b)	9, 15
11 U.S.C. § 1129(b)(1)	9
11 U.S.C. § 1129(b)(2)	*passim*
11 U.S.C. § 1129(b)(2)(B)	10
11 U.S.C. § 1129(b)(2)(B)(ii)	9, 10
28 U.S.C. § 1408	6

TABLE OF AUTHORITIES—Continued

Other Authorities	Page
Administrative Office of the U.S. Courts, *Calendar Year 1997 Shows Bankruptcy Filings Up 19 Percent Over 1996* (press release Feb. 27, 1998)	8
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David R. Kuney & Timothy R. Epp, *Aftermath of* Bonner Mall: *Evolution or Regression in the Notion of "New Value"?*, 5 J. Bankr. L. & Prac. 211 (1996)	7
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Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69 (1991)	13
Supreme Court Rule 10(a)	6

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BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE* [1]

ACLI is the principal national trade association of life insurance companies. The 532 member companies of ACLI account for eighty-nine percent of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1996, life insurance companies' net investment in U.S. money and capital markets totaled $107 billion, more than ten

[1] In accordance with Supreme Court Rule 37.6, ACLI represents that no party other than counsel for ACLI authored this brief in whole or in part, and no person or entity, other than ACLI, has made a monetary contribution to the preparation of submission of this brief.

percent of total institutional funds flowing into the financial markets. American Council of Life Insurance, *Life Insurance Fact Book* 50 (1997). At year-end 1996, life insurers held $951.7 billion in corporate bonds and $207.8 billion in mortgages. *Id.* at 53, 102.

The interest of ACLI as *amicus* arises out of the importance of this case to the commercial lending community. As a principal source of investment capital for both real estate developments and operating businesses, life insurance companies have a broad and important perspective on the need for this Court's review of this case.

Life insurance companies, like all lenders, presently are faced with conflicting rules as to the propriety of a bankruptcy reorganization plan that grants the debtor's owners ("old equity"), and only old equity, the right to purchase ownership of the reorganized debtor by contributing additional capital to the debtor's bankruptcy estate (an "equity-only new value right"). The courts of appeals, district courts, and bankruptcy courts are divided on whether the Bankruptcy Reform Act of 1978, 11 U.S.C. § 101 et seq. (as amended, the "Bankruptcy Code") permits an equity-only new value right, as are the law review and treatise writers.

Lenders make credit decisions, price loans, and bargain for security and other terms based in part on the risks of nonpayment and the potential for recovery in the event of default. Lenders (and borrowers) need a uniform national rule of bankruptcy rights and priorities. Uncertainty as to the rights and priorities of debt holders and equity holders adversely affects credit decisions, the cost of credit, and the consensual resolution of troubled loans. Review of the decision of the Court of Appeals is thus vitally important to ACLI and its members.

SUMMARY OF REASONS FOR GRANTING THE WRIT

The five courts of appeals that have considered the issue presented in this case—whether an equity-only new value right meets the requirements of the Bankruptcy

Code's absolute priority rule—are divided. This division at the appellate level reflects a split in the bankruptcy courts, sometimes among judges in the same judicial district. A decision from this Court on the merits is necessary to establish a uniform nationwide rule of decision.

The equity-only new value question is an issue of great importance to both creditors and debtors. Clarification of this area of the law will remove significant uncertainties from the processes of negotiating and litigating bankruptcy reorganization plans and will enable the credit markets to allocate bankruptcy-related risks appropriately. This Court recognized the importance of this issue by granting certiorari in *Bonner Mall* four Terms ago.

The Court of Appeals in this case disregarded the significance of Congress' deliberate statutory choices in enacting the Bankruptcy Code in 1978 and misread the plain language of the statute that resulted from those choices. At the same time, the Court of Appeals misunderstood pre-Bankruptcy Code law and ignored crucial differences between that law and present law. The resulting decision of the Court of Appeals is inconsistent with the language of the Bankruptcy Code, with congressional intent, and with several decisions of this Court.

REASONS FOR GRANTING THE WRIT

I. THE COURTS OF APPEALS, DISTRICT COURTS, AND BANKRUPTCY COURTS ARE DIVIDED ON WHETHER AN EQUITY-ONLY NEW VALUE RIGHT IS CONSISTENT WITH ABSOLUTE PRIORITY.

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court expressly declined to address the United States' argument as *amicus curiae* that Congress' "codification of the absolute priority rule eliminated any 'exception' to that rule suggested by [*Case v.*] *Los Angeles Lumber* [*Products Co.*, 308 U.S. 106 (1939)]." *Id.* at 203 n.3. The Court recognized, however, that the vitality

of the new value doctrine[2] is "a question which has divided the lower courts since passage of the Code in 1978." *Id.* The division over new value and absolute priority has intensified since *Ahlers*, the only consensus is the need for Supreme Court review.

A divided Seventh Circuit panel held in this case that a plan of reorganization may grant old equity, *and only old equity*, the right to purchase the ownership of the reorganized debtor without competitive bid or counter-proposal by creditors or others.[3] That holding sanctioned the conferral on old equity of what is in essence an "equity-only new value right."[4]

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[2] Like most other courts, this Court has referred to the new value doctrine as an "exception" to the absolute priority rule. *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18, 20 & n.1 (1994); *Ahlers*, 485 U.S. at 203 n.3. The majority opinion of the Court of Appeals panel in this case, for the most part, preferred the phrase "new value corollary." App. to Pet. for Cert. at 14a. We refer to the issue generally as the "new value doctrine" and to the new value issue involved in this case as an "equity-only new value right."

[3] It is not surprising that the Seventh Circuit panel was divided in this case. In *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1361-62 (7th Cir. 1990), Judge Easterbrook strongly suggested that the new value doctrine did not survive the enactment of the Bankruptcy Code. Later, in *In re Snyder*, 967 F.2d 1126, 1129-30 (7th Cir. 1992), Judge Cudahy strongly suggested just the opposite. In both cases, the panels held that even if the new value doctrine were viable, the debtor's proposed new value contribution did not satisfy the requirements of the doctrine. *See Kham & Nate's Shoes No. 2*, 908 F.2d at 1362; *Snyder*, 967 F.2d at 1131. The Seventh Circuit denied rehearing en banc in the case at bar by an evenly divided vote. *See* App. to Pet. for Cert. at 49a.

[4] A red herring frequently colors the arguments of debtors and courts in favor of an equity-only new value right. It is the erroneous conclusion that without an equity-only new value right, old equity would be barred from owning an interest in the reorganized debtor unless either (1) all classes of creditors accepted the plan or (2) all creditors were to be paid in full. The Ninth Circuit, for example, reasoned that if an equity-only new value right were

In five circuts, courts of appeals have taken positions on whether an equity-only new value right is inconsistent with the absolute priority rule of Section 1129(b). In addition to the Seventh Circuit's decision in this case, the Eighth and Ninth Circuits have authorized equity-only new value rights. *In re Ahlers*, 794 F.2d 388, 401-42 (8th Cir. 1986), *rev'd on other grounds*, 485 U.S. 197 (1988);[5] *In re Bonner Mall Partnership*, 2 F.3d at 907.[6] The Sixth Circuit has approved the confirmation of a plan containing an equity-only new value right without directly

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impermissible, "[w]e would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor [where senior classes are not paid in full]." *In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994). The law does not require, and ACLI does not suggest, that old equity may never own or control the reorganized debtor unless all classes of creditors either consent to the plan or are paid in full. The absolute priority rule does prohibit a plan that gives old equity greater rights to buy assets of or interests in the debtor than other parties in interest receive. For example, a new value right that is limited to old equity only is a grant of property to old equity on account of old equity's ownership of the debtor and triggers the prohibition of 11 U.S.C. § 1129(b)(2), as explained *infra* at 10-11.

[5] The Eighth Circuit decided *Ahlers* in a procedural posture in which no reorganization plan had been filed, and the court's opinion does not address specifically whether the debtors' right to purchase the equity in their farm would be exclusive. Instead, the contemplated new value considered by the Eighth Circuit was the debtors' "farm operation and management skills," which presumably could be provided only by the debtors. *Ahlers*, 794 F.2d at 402.

[6] In *Bonner Mall*, the Ninth Circuit held squarely that a plan may grant exclusively to old equity the right to purchase ownership for new value. 2 F.3d at 910-11. The Ninth Circuit's conclusion apparently was bolstered by its belief that the expiration of the debtor's exclusive period to file a plan under 11 U.S.C. § 1121 affected the propriety of the equity-only plan. *See id.* at 910 n.26. The issue in the instant case is the exclusivity of the right granted to old equity to purchase ownership of the debtor, not the exclusivity of the debtor's right to file a plan.

addressing the issue. *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986).

The Second Circuit recently addressed this issue at length and held that the absolute priority rule does not permit equity-only new value rights. *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Assocs., L.P.*, 1998 WL 90844, at *3 (2d Cir. Feb. 19, 1998). Earlier, the Fourth Circuit reached the same conclusion. *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992). And a panel of the Fifth Circuit initially so held, but the panel withdrew the relevant portion of its opinion after concluding that it did not need to reach the issue. *In re Greystone III Joint Venture*, 995 F.2d 1274, 1284 (5th Cir. 1991), *withdrawn in part*, 995 F.2d at 1284 (5th Cir.), *cert. denied*, 506 U.S. 821, 822 (1992).

This sharp division among the courts of appeals is alone sufficient to justify this Court's exercise of its certiorari jurisdiction. *See* Sup. Ct. R. 10(a). For a lender, however, the division among the bankruptcy courts has an even greater impact than the circuit split. Bankruptcy courts are responsible for applying the absolute priority rule in the first instance. The economics of many Chapter 11 cases limit lenders to proceedings in the bankruptcy court; costs and delay deter the first appeal to the district court or bankruptcy appellate panel, much less the second appeal to the court of appeals.

Because of the bankruptcy venue rules, sharp divisions among the courts on new value issues make it nearly impossible to evaluate the bankruptcy-related risk of a particular borrower. *See* 28 U.S.C. § 1408. For example, the principals of the debtor in *Coltex* surely regret filing for bankruptcy protection in New York, where their equity-only new value plan caused the Second Circuit to conclude that an equity-only new value right is impermissible. Had they filed in Delaware, where the debtor was organized, they might have found support for their position

in *In re VIP Motor Lodge, Inc.*, 133 B.R. 41 (Bankr. D. Del. 1991); had they filed in the Southern District of Texas, where the debtor's principal assets were located, they could have argued about new value on a clean slate.

And even if a creditor could somehow divine at the time of the transaction where the debtor might file for bankruptcy protection, it still might not know whether the debtor would receive the benefit of an equity-only new value right. In certain districts, the permissibility of an equity-only new value right may depend on the turn of the wheel that decides which judge is assigned the case. For example, in the Northern District of Georgia[7] and the Western District of Pennsylvania,[8] bankruptcy judges have published equity-only new value decisions in direct contradiction of their colleagues. In light of the split among the courts of appeals, there is little likelihood that these inter-district and intra-district divisions will be resolved consistently.[9]

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[7] *Compare In re Moonraker Assocs., Ltd.*, 200 B.R. 950, 954-56 (Bankr. N.D. Ga. 1996) (equity-only new value right is permissible) *with In re Homstead Partners, Ltd.*, 197 B.R. 706, 716 (Bankr. N.D. Ga. 1996) (equity-only new value right is not permissible).

[8] *Compare In re Tallahassee Assocs., L.P.*, 132 B.R. 712, 717 (Bankr. W.D. Pa. 1991) (equity-only new value right is permissible) *with In re Winters*, 99 B.R. 658, 663 (Bankr. W.D. Pa. 1989) (equity-only new value right is not permissible).

[9] Further confusion results from the inablity of courts that allow equity-only new value rights to agree about what old equity must offer to qualify. One common formulation of the requirements draws from *Los Angeles Lumber* the proposition that old equity must "offer value under the Plan that is (1) new, (2) substantial, (3) in money or money's worth, (4) necessary for successful reorganization, and (5) reasonably equivalent to the value or interest received." *In re Ambanc La Mesa Ltd. Partnership*, 115 F.3d 650, 654 (9th Cir. 1997), *cert. denied*, 118 S. Ct. 1039 (1998). (The debtor in *Ambanc* petitioned for certiorari, but its petition raised questions only as to the elements of the new value doctrine.) The courts' efforts to apply this test have led to numerous inconsistent results. *See* David R. Kuney & Timothy R. Epp, *Aftermath of*

II. THE AVAILABILITY OF AN EQUITY-ONLY NEW VALUE RIGHT IS AN ISSUE OF EXCEPTIONAL IMPORTANCE TO LENDERS AND BUSINESS OWNERS.

The reported cases discussed above reflect only a small portion of the impact of uncertainty about the new value doctrine upon creditors and debtors. In 1997, 9694 businesses filed for Chapter 11 protection, at least one in every judicial district in the United States. *See* Administrative Office of the U.S. Courts, *Calendar Year 1997 Shows Bankruptcy Filings Up 19 Percent Over 1996*, at tbl. F-2 (press release Feb. 27, 1998). Most decisions of bankruptcy courts in these Chapter 11 cases remain unreported. In many of these cases, creditors and debtors reach consensual solutions to disputed issues, after negotiations that are complicated by the uncertainty in this area of bankruptcy law.

The question of the existence and content of the new value doctrine is one of the most important issues of bankruptcy law today. The absolute priority rule lies at the heart of bankruptcy reorganization. It reflects the nonbankruptcy ordering of rights and priorities between holders of debt and equity and "sets the ground rules of Chapter 11." Douglas G. Baird, *The Elements of Bankruptcy* 73 (1992). If old equity is permitted an exclusive opportunity to capture the value of the reorganized debtor by contributing new capital to the debtor's estate at a price set by the bankruptcy judge, lenders will adjust their credit decisions to account for this upsetting of nonbankruptcy priorities.

The Court recognized the importance of the issue presented in this case by granting certiorari in *Bonner Mall*, but the parties' settlement prevented the Court from reaching the merits. *Bonner Mall*, 513 U.S. at 20 n.1. The

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Bonner Mall: *Evolution or Regression in the Notion of "New Value"?*, 5 J. Bankr. L. & Prac. 211, 234-46 (1996) (collecting cases).

issue is no less important today, as debtors and creditors continue to struggle with inconsistent interpretations of the absolute priority rule.

The importance of the proper application of the absolute priority rule also has a temporal reach far beyond bankruptcy proceedings. A lender making a determination whether to extend credit in the first instance must consider the worst possible outcome. For a lender, the worst possible outcome is (1) failure of the debtor to repay its obligations, followed by (2) a bankruptcy filing, followed by (3) failure of the debtor to propose a plan of reorganization that meets with the approval of the majority of a class of unsecured creditors, followed by (4) a cramdown that gives old equity, and only old equity, the opportunity to retain ownership of the debtor for "new value" at a price fixed by old equity and the bankruptcy judge rather than the market. In an environment in which lenders cannot predict whether a particular court will confirm a plan containing an equity-only new value right, a prudent lender will adjust its credit standards accordingly. The impact of such credit decisions on the capital markets nationwide argues strongly in favor of this Court's exercise of its jurisdiction to review the decision of the Court of Appeals.

III. THE DECISION OF THE COURT OF APPEALS IS INCONSISTENT WITH THE PLAIN MEANING OF SECTION 1129(b) OF THE BANKRUPTCY CODE, THIS COURT'S JURISPRUDENCE ON THE INTERPRETATION OF THE BANKRUPTCY CODE, AND BANKRUPTCY POLICY.

This case involves the text of a single subsection of the Bankruptcy Code, Section 1129(b)(2)(B)(ii). Twenty years ago, Congress codified the absolute priority rule, which previously was a matter of federal common law, as part of the Bankruptcy Code's requirement that a reorganization plan be "fair and equitable" to be confirmed over the objection of a class of creditors. 11 U.S.C.

§ 1129(b)(1). Section 1129(b)(2) provides that when a Chapter 11 plan is crammed down on a dissenting class of creditors, it is not fair and equitable unless:

> (B) With respect to a class of unsecured claims—
>
> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B). This is a clear congressional statement that if a class of unsecured creditors objects to a plan that does not propose full repayment of those unsecured creditors, a junior class cannot receive or retain any property under the plan because of its claim against or interest in the debtor. There is no dispute in the courts that an equity interest in the reorganized debtor, whatever its value, constitutes "property" for purposes of the absolute priority rule. *Ahlers*, 485 U.S. at 207-08. Similarly, old equity's exclusive opportunity to purchase this property is itself "property." *Bryson*, 961 F.2d at 504.

Section 1129(b)(2) does not prohibit old equity from becoming the owner of the reorganized debtor. Old equity has the same opportunity to purchase assets or ownership of the bankruptcy estate as any other interested investor. Section 1129(b)(2), however, does prohibit a Chapter 11 plan that confers an old equity greater rights to buy assets or ownership of the estate than other possible buyers have. A plan that provides for an equity-only new value right enables old equity to receive or retain property "on account of such junior . . . interest." 11 U.S.C. § 1129(b)(2)(B)(ii); *see also* App. to Pet. for Cert. at 34a-35a (Kanne, J., dissenting). The property received in violation of Section 1129(b)(2) is the exclusive opportunity to purchase ownership.

This Court's decisions on the interpretation of the Bankruptcy Code demonstrate that the Court of Appeals erred in affirming confirmation of respondent's plan. In *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), this Court stated:

> The task of resolving the meaning of [a section of the Bankruptcy Code] begins where all such inquiries must begin: with the language of the statute itself. In this case, it is also where the inquiry should end, for where, as here, the statute's language is plain, "the sole function of the courts is to enforce it according to its terms."

Id. at 241 (citations omitted). The Court of Appeals erroneously concluded that the language of the absolute priority rule was ambiguous because courts and commentators have reached different conclusions about its proper interpretation. *See* App. to Pet. for Cert. at 18a-19a. If disagreements among judges and scholars were sufficient to make a statute ambiguous, this Court would not have relied on the plain language of the Bankruptcy Code in *Ron Pair*. *See Ron Pair*, 489 U.S. at 238 & n.1 (collecting decisions and commentary reaching conflicting conclusions about interpretation of 11 U.S.C. § 506(b)); *see also Toibb v. Radloff*, 501 U.S. 157, 160-61 (1991) (following plain language of Bankruptcy Code despite disagreement among courts).

After concluding that the statute was ambiguous, the Court of Appeals turned for guidance to the law and practice under the Bankruptcy Act of 1898 (formerly codified at 11 U.S.C. § 1 et seq. (repealed 1979)) (the "Bankruptcy Act"). The Court of Appeals relied on this Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), in which the Court expressed its reluctance "to accept arguments that would interpret the Code, however vague the particular language under consideration might

be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Id.* at 419.[10] The Court of Appeals concluded that the new value doctrine had a longstanding heritage under the Bankruptcy Act and that Congress evidenced no intent to eliminate the doctrine when it enacted the Bankruptcy Code. *See* App. to Pet. for Cert. at 20a-23a. Both conclusions are incorrect.

The Bankruptcy Act heritage of the new value doctrine is limited at best. In *Los Angeles Lumber*, the Court considered whether the requirement in Section 77B of the Bankruptcy Act that a plan be "fair and equitable" required creditors to be accorded absolute priority or merely relative priority. Both Section 77B and Chapter X of the Bankruptcy Act, which had already superseded Section 77B by the time *Los Angeles Lumber* was decided, contained the phrase "fair and equitable" without further elaboration on the relative priority of creditors and old equity. *See* Act of June 7, 1934, ch. 424, sec. 1, § 77B(f), 48 Stat. 911, 919 (superseded 1938); 11 U.S.C. § 621(2) (repealed 1979). The Court held that absolute priority was required and then continued, in dicta, to describe a possible situation in which old equity could participate in a reorganization. *Los Angeles Lumber*, 308 U.S. at 115-16, 121-22.[11]

Neither in *Los Angeles Lumber* nor in any other published decision under the Bankruptcy Act from 1939 to 1978 did any court conclude that a new value exception to the absolute priority rule applied to the facts of a case. *See* Kenneth N. Klee, *Valuation and Cram Down*, SB37

[10] In *Dewsnup*, the Court also recognized that "where the language is unambiguous, silence in the legislative history cannot be controlling." *Id.* at 419-20. That principle should control this case.

[11] This Court stated shortly thereafter that the rule of absolute priority applied in Chapter X as well as under Section 77B. *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942).

ALI-ABA 455, 469 (1997); 7 *Collier on Bankruptcy* ¶ 1129.04[4][c], at 1129-107 (Lawrence P. King ed., 15th ed. rev. 1997); Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991). Accordingly, the pre-Bankruptcy Code new value doctrine existed only in dicta, in stark contrast to the line of Bankruptcy Act cases on the survival of liens that this Court found persuasive in *Dewsnup*. *See Dewsnup*, 502 U.S. at 418-19. More importantly, whatever new value exception existed under the Bankruptcy Act was available *only* where it had the approval of all classes of creditors. *See Los Angeles Lumber*, 308 U.S. at 114. It would not have applied to a case like the instant case, where the affected class has rejected the plan.

In 1978, Congress completely rewrote business bankruptcy reorganization law. *See Ron Pair*, 489 U.S. at 240 (recognizing that Congress "made significant changes in both the substantive and procedural laws of bankruptcy" and conducted "a substantial overhaul of the system"). In the Bankruptcy Code, Congress for the first time enunciated what makes a plan of reorganization "fair and equitable." 11 U.S.C. § 1129(b)(2). Congress codified the absolute priority rule, which was a solidly established rule under Chapter X of the Bankruptcy Act, but made no mention of the new value doctrine, which was a part of Bankruptcy Act practice only in theory. To the extent that the new value doctrine was a part of past practice at all, this congressional decision alone is "a clear indication that Congress intended . . . a departure" from past practice. *See Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990); *Union Bank v. Wolas*, 502 U.S. 151, 160 (1991) ("[T]he fact that Congress carefully reexamined and entirely rewrote the preference provision in 1978 supports the conclusion that the text of § 547(c)(2) as enacted reflects the deliberate choice of Congress.").

The House Report accompanying the bill that enacted the Bankruptcy Code stated that the bill contained "a

partial application of the absolute priority rule now applied under Chapter X" and a "*partial* codification of the absolute priority rule." H.R. Rep. No. 95-595, at 224, 414 (1977) (emphasis added), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6184, 6370. This legislative history reflects Congress' intent to rework the law of business reorganization significantly, adopting the absolute priority rule from one chapter of the Bankruptcy Act and applying it in modified form. Whatever role the new value doctrine may have played in Bankruptcy Act practice, Congress did not intend to import it into the Bankruptcy Code.

Other actions further demonstrate Congress' intent to rework the law of business reorganization. Among the significant changes wrought by Congress was the replacement of three business reorganization chapters of the Bankruptcy Act (Chapters X, XI, and XII) with a single chapter in the Bankruptcy Code (Chapter 11). Chapter 11 of the Bankruptcy Code incorporated certain features of the Bankruptcy Act's reorganization chapters and included several important new provisions:

- Chapter X of the Bankruptcy Act required the appointment of a disinterested trustee to manage any debtor with liabilities of $250,000 or more. 11 U.S.C. § 556 (repealed 1979). In contrast, the debtor normally remained in possession of its assets under Chapters XI and XII. 11 U.S.C. §§ 742, 844 (repealed 1979). In the Bankruptcy Code, Congress drew on Chapters XI and XII and created a preference for debtor control except in extraordinary situations. *See* 11 U.S.C. §§ 1104(a), 1107(a).

- Any party in interest could propose a reorganization plan in Chapter X of the Bankruptcy Act. 11 U.S.C. § 569 (repealed 1979). Only the debtor could propose an arrangement in Chapters XI and XII. 11 U.S.C. §§ 706(1), 723, 823 (repealed 1979). Congress created a hybrid rule in Bankruptcy Code, giving the debtor-in-possession the exclusive right to propose a plan for the first 120 days after the entry of an order for relief and allowing the court to extend that exclusive period. 11 U.S.C. § 1121.

- The absolute priority rule applied rigorously in cases under Chapter X of the Bankruptcy Act; the affected creditors were not permitted to consent to non-priority treatment in a reorganization plan. *Los Angeles Lumber*, 308 U.S. at 114. The "fair and equitable" standard, including the absolute priority rule, did not apply at all in Chapters XI and XII after Congress amended the Bankruptcy Act in 1952. *SEC v. American Trailer Rentals Co.*, 379 U.S. 594, 606 n.8 (1965); *In re Mallard Assocs.*, 475 F. Supp. 1045, 1053 (S.D.N.Y. 1979). In the Bankruptcy Code, Congress imported the absolute priority rule from Chapter X of the Bankruptcy Act, codified it for the first time, and made it applicable only when a class of creditors dissents (and then only as to the dissenting class). *See* 11 U.S.C. § 1129(a)-(b).

In sum, Congress created a new law of business reorganization in 1978, adopting elements of the reorganization chapters of the Bankruptcy Act that it found worthwhile. The decision of the Court of Appeals ignores the plain language of the Bankruptcy Code and reads into the Bankruptcy Code an unwarranted intent to continue pre-Bankruptcy Code practices.

Congress' rewriting of bankruptcy law in 1978 also reflected a shift in policy. Especially in the area of plan confirmation, Congress gave responsibility to parties in interest, rather than judges, to determine what is in the parties' best interests. In some cases, creditors may conclude that they will benefit if old equity retains ownership and, in appropriate cases, management control of the reorganized debtor. Empirical evidence suggests that creditors frequently accept plans that would not satisfy the absolute priority rule. *See* Lynn M. LoPucki & William

C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990); Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989).

The equity-only new value right approved in the instant case operates differently, however, as the Seventh Circuit explained in another case:

> Creditors effectively own bankrupt firms. They may find it worthwhile, as owners, to sell equity claims to the managers; they may even find it worthwhile to give the equity away in order to induce managers to stay on and work hard. . . . When there is value to be gained by allowing a lower class to kick in new value and keep its interest, the creditors should be willing to go along. A "new value exception" means a power in the *judge* to "sell" stock to the managers even when the creditors believe that this transaction will *not* augment the value of the firm.

Kham & Nate's Shoes No. 2, 908 F.2d at 1360 (citation omitted). This Court recognized as much in *Ahlers*:

> [T]he Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which . . . fails to honor the absolute priority rule.
>
> The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code.

Ahlers, 485 U.S. at 207 (citation omitted).

The decision of the Court of Appeals places the bankruptcy judge in the position of first determining that old equity's proposed payment is "necessary" and "substantial" (without determining whether creditors or others would be willing to pay the bankruptcy estate the same amount

or more) and then deciding that it is in the creditors' best interests that old equity receive ownership of the reorganized debtor in exchange for this payment. As Congress directed in the Bankruptcy Code and this Court recognized in *Ahlers*, that decision is for the creditors to make.

CONCLUSION

For the reasons stated herein and in the Petition for Writ of Certiorari, the Petition should be granted.

Respectfully submitted,

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No. 97-1418

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF OF THE AMICI CURIAE AND BRIEF OF THE AMICI CURIAE AMERICAN BANKERS ASSOCIATION and CALIFORNIA BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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In accordance with the provisions of Rule 37.2(b) of the Supreme Court Rules, the American Bankers Association and California Bankers Association hereby respectfully move

the Court for leave to file the attached brief as amici curiae in support of the Petitioner. The Petitioner has granted consent to this filing but the Respondent has withheld consent.

The American Bankers Association is the principal national trade association of the banking industry in the United States. Its membership includes both commercial banks and thrift institutions located in each of the fifty states and the District of Columbia, and those institutions hold approximately ninety percent of the domestic assets of the industry.

The California Bankers Association is the principal state-based trade association for the lending industry in California, representing virtually all of the commercial banks and trust companies in that state.

Both associations frequently appear in litigation either as a party or as amicus curiae in cases raising issues of widespread importance to their members. Litigation over the alleged "new value exception" to the absolute priority rule in bankruptcy is a case in point. The American Bankers Association was permitted to appear as amicus curiae in this Court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), a case in which the question raised by this case was left open. Both associations were permitted to appear as amici curiae in *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18 (1994), a case in which this Court granted certiorari in order to resolve the same conflict among the circuits that justifies the grant of certiorari in this case. The conflict was not resolved in *Bonner Mall* due to a settlement of the case prior to argument in this Court. The conflict thus continues and has in fact been exacerbated since

1994. Consequently, the interests of the two associations in securing a uniform understanding and application of national bankruptcy law, which only this Court can now supply, remain unchanged from the earlier cases.

We therefore urge the Court to grant leave to the associations once again to provide what we hope will be a perspective on the issues that is broader than those of the immediate parties to this case.

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QUESTION PRESENTED

Whether the Bankruptcy Code authorizes the confirmation of a Chapter 11 plan of reorganization that provides that existing equity owners will contribute "new value" to the reorganization and will own equity in the reorganized debtor, even though the plan does not provide for full payment to a senior, objecting class of unsecured creditors.

TABLE CONTENTS

	Page
INTEREST OF THE AMICI CURIAE.....	2
REASONS FOR GRANTING THE WRIT.....	4
CONCLUSION.....	7

TABLE OF AUTHORITIES

	Page
CASES:	
In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993), *cert. granted*, 510 U.S. 1039 (1994).....	4, 5
In re Bryson Properties, XVIII, 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992).....	4
In re Coltex Loop Central Three Partners, L.P., No. 96-5140 (2d Cir. Feb. 19, 1998).....	6
In re Greystone III Joint Venture, 995 F.2d 1274 (5th Cir. 1991).....	5
In the Matter of 203 North LaSalle Street Partnership, 126 F.3d 955 (7th Cir. (1997).....	2, 3, 6
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988).....	4
U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 513 U.S. 18 (1994).....	5
STATUTES:	
11 U.S.C. § 1129(b).....	3
11 U.S.C. § 1129(b)(2).....	4

11 U.S.C § 1129(b)(2)(B)(ii)..... 4

MISCELLANEOUS:

Trost, *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595 (1997)..... 3

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1997

NO. 97-1418

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Petition for Writ of Certiorari
to the United States Court of Appeals
for the Seventh Circuit

BRIEF OF THE AMICI CURIAE[1] AMERICAN BANKERS ASSOCIATION and CALIFORNIA BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

---

[1] No counsel for any party had any role in authoring this brief and no person other than amici curiae made any monetary contribution to its preparation or submission.

The American Bankers Association and California Bankers Association hereby respectfully submit this brief as amici curiae in support of the Petitioner in accordance with the provisions of Rule 37.2 of the Supreme Court Rules.

INTEREST OF THE AMICI CURIAE

As indicated in the foregoing motion, the American Bankers Association and California Bankers Association are, respectively, the principal trade associations for the lending industry nationwide and in the State of California. As representatives for that industry, the associations have a vital interest in this case. The uncertainty as to the existence of a "new value exception" to the absolute priority rule that is engendered by the continuing conflict among the lower courts adds to the litigation costs of lenders and affects the "settlement" value of cases to the detriment of lenders. If the decision of the court of appeals in this case remains unreviewed and unreversed, then the capacity of debtors to retain equity interests in property without paying objecting creditors in full, at least in the states of the Seventh Circuit and California and the other states of the Ninth Circuit, will adversely affect lenders' litigation and negotiation strategy in bankruptcy cases, their willingness to make new loans on terms and conditions and at prices that would have been in effect otherwise, and their willingness to work out troubled loans as well.

A "new value exception" to the absolute priority rule, admittedly found nowhere in the statutory language,[2] is costly and disruptive, and upsets the priorities Congress clearly placed in the statute after long and careful deliberation. Since virtually all debtors are insolvent, the costs of bankruptcy fall almost exclusively upon creditors, many of whom are represented by your amici. The "exception," if it is found to exist, delays resolution of bankruptcy cases, gives additional leverage to owners, substitutes a vague standard for the specific statutory language of Section 1129(b), thereby increasing transaction costs, and ultimately transfers reorganization value from creditors (where Congress said it belongs) to existing owners.

This is not merely a matter of academic interest, more theoretical than real, but rather a matter of great practical consequence to lenders and debtors alike. It is a matter that is litigated with considerable regularity, but with no consistent outcome. Indeed, as the Petition for Writ of Certiorari points out, there have been over 100 published cases from the lower courts on point since this Court's *Ahlers* decision ten years ago. (Petition for Writ of Certiorari at 13, citing Trost, *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595, 677-699 (1997)).

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[2] "At the time it codified the absolute priority rule, Congress did not explicitly codify the new value corollary." *In the Matter of 203 North LaSalle Street Partnership*, 126 F.3d 955, 963 (7th Cir. 1997).

REASONS FOR GRANTING THE WRIT

The Conflict Among The Circuits

A Chapter 11 Plan can only be confirmed if it is (among other things) "fair and equitable." 11 U.S.C. § 1129(b)(2). Part of what that means is that each class of unsecured creditors must be provided for in full before junior classes can receive or retain any property (unless, of course, the class in question consents to a plan that provides otherwise.) *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988). "The holder of any claim or interest that is junior to the claims of [the dissenting class] will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii).

In *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992), the court held that, at the very least, where the proponents of a Chapter 11 Plan (equity owners of the corporate debtor) sought to grant themselves an *exclusive* right to contribute new capital, such an "exclusive right to contribute constitutes 'property' under § 1129(b)(2)(B)(ii), which was received or retained *on account of* a prior interest." *Id.* at 504. (emphasis added.)

The following year, in *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), the court likewise dealt with a plan that provided to the equity owners of the debtor partnership the exclusive right to contribute new capital in exchange for corporate stock in the reorganized business. Unlike the Fourth Circuit, however, the Ninth Circuit concluded that the receipt or retention of "property" by the "junior class under these circumstances would not be "on account of" the class's earlier interest in the partnership,

but rather was "*on account of* a substantial, necessary and fair new value contribution." *Id.* at 909 (emphasis in original.).

A third circuit had, by 1993, also weighed in on the subject, though inconclusively. In *In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991), a three-judge panel of the court dismissed the "on account of" argument as so much "wordplay, because Greystone intends to prevent creditors from acceding to ownership of the property *on account of* Greystone's unique status as an old equity contributor to the plan." *Id.* at 1283 (emphasis in original.) Rehearing was granted in part in that case, and the cited portion of the panel's opinion was withdrawn, 995 F.2d 1284 (5th Cir.)(per curiam), *cert. denied*, 506 U.S. 821 (1992).

In order to resolve the then-existing confusion among the circuits, this Court granted certiorari in *Bonner Mall*, 510 U.S. 1039 (1994). Subsequent to that, however, the parties settled among themselves, resulting in a dismissal of the case as moot, *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18 (1994), and thereby postponing until another day the resolution of the conflict. That day is now.

Since the dismissal of *Bonner Mall*, the conflict among the circuits has continued and intensified. In the case below, the Seventh Circuit joined forces with the Ninth, asserting that there was an "ambiguity" in the "on account of" language, and concluding "that it is more reasonable to believe that Congress legislated on the understanding that, in new value transactions, old equity owners receive stock in exchange for the additional capital they invest....[T]he

opportunity to participate in a reorganization plan, even an exclusive right, is not retained on account of an old equity holder's former ownership interest." *In the Matter of 203 North LaSSalle Street Partnership*, 126 F.3d at 965-966.

Then, mere days before the Petition for Writ of Certiorari was filed in this case, the Second Circuit handed down its contribution to the discussion in *In re Coltex Loop Central Three Partners, L.P.*, No. 96-5140 (2d Cir. Feb. 19, 1998). That court's decision adheres closely to the reasoning of the Fourth Circuit and the withdrawn panel opinion in the Fifth Circuit, concluding that an exclusive right to retain a property interest in the debtor's property by means of contributing new capital is itself "property" that is received "on account of" the owners' prior status. Slip op. at 9. Indeed, the Second Circuit's opinion paints the conflict among the circuits in sharp colors when it makes a point of adopting the dissenting opinion in *LaSalle*. (*Id.*, Slip. op. at 8).

CONCLUSION

The two schools of thought represented by the above-cited cases are clearly irreconcilable. There is not even any clear "trend" in the decisions of the lower courts one way or the other. Only this Court can bring certainty to an important area of the law resolving a conflict that has plagued the lower courts, the bar, and the lending industry for at least a decade. The Petition should be granted.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Successor by merger to Bank of America Illinois,
PETITIONER

v.

203 NORTH LASALLE STREET PARTNERSHIP,
RESPONDENT

On Writ of Certiorari
to the United States Court of Appeals
for the Seventh Circuit

PETITIONER'S OPPOSITION TO RESPONDENT'S MOTION TO DISMISS

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PETITIONER'S OPPOSITION TO RESPONDENT'S MOTION TO DISMISS

This Court has already considered and rejected respondent's argument that "equitable mootness" was a reason to deny certiorari. Furthermore, three levels of the federal judiciary have considered the "equitable mootness" argument on the merits and have unanimously rejected it. See Pet. App. 10a-11a (Seventh Circuit), 60a (district court); 12/5/95 Tr. 14-18 (bankruptcy court). Those courts were bound by the one and only precedent respondent cites in its motion to dismiss,[1] yet they thought the precedent obviously distinguishable from this case. Indeed, the author of that precedent — Judge Easterbrook — voted to grant *petitioner's* suggestion of rehearing en banc, which respondent opposed on the ground that the case is equitably moot. See Pet. App. 49a.

The thrice-rejected "equitable mootness" argument not only was mentioned in respondent's unsuccessful brief in opposition, but was the principal argument in that brief. See Br. in Opp. 9-15; see also Reply Br. 4-8. There is no reason to think that the Court missed the issue. Nor does respondent's contention have any more merit now than it did two and a half weeks ago when the Court granted certiorari, or two and a half years ago when the bankruptcy court became the first of several courts to reject it.[2] For all of the reasons given in petitioner's reply brief, the "equitable mootness" argument provides no reason to deny certiorari, and especially provides no reason to dismiss the writ as improvidently granted.

---

[1] *In re UNR Industries, Inc.*, 20 F.3d 766, 771 (7th Cir. 1994).

[2] Respondent relies most heavily for its mootness argument on the fact that the order confirming the plan of reorganization was *unstayed*. Yet that order was unstayed *precisely because* the bankruptcy court determined that the case would not become moot — equitably or otherwise — if that court denied a stay. See Reply Br. 5-6 (citing 12/4/95 and 12/5/95 Trs.). The "justifiable reliance" that respondent emphasizes (Mtn. to Dismiss 1) is a phrase more aptly applied to petitioner's reliance on the holdings of the courts below that the bankruptcy court's failure to enter a stay would not preclude full appellate litigation of the merits.

It bears repeating that respondent does *not* and could not contend that this case is moot in the Article III sense. Rather, respondent argues, in essence, that it is unfair to reverse an unstayed order confirming a plan of reorganization. But respondent and others have long been on notice of petitioner's intent to seek appellate review of the confirmation order. There is nothing unfair about allowing petitioner to obtain judicial review on the merits, nor is there any reason for this Court to avoid resolution of the eminently certworthy issue in this case because of respondent's often-repeated and often-rejected claims of unfairness.

The motion to dismiss should be denied.

Respectfully submitted.

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Successor by merger to Bank of America Illinois,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

MOTION TO DISMISS

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MOTION TO DISMISS WRIT OF CERTIORARI AS IMPROVIDENTLY GRANTED

Respondent, 203 North LaSalle Street Partnership, moves to dismiss the writ of certiorari issued in this case as improvidently granted. Regardless of the importance which this Court attaches to the issue on which certiorari was granted, considering that issue in this case, in the context of an unstayed order confirming a substantially consummated plan of reorganization, is a mistake.

Merely, issuing the writ has created a substantial risk that good faith transactions consummated in reliance on unstayed orders confirming plans of reorganization can be rescinded, thereby:

a) harming creditors in many pending reorganization cases by reducing the realizable value of assets, and

b) encouraging frivolous appeals.

When deciding how much to offer creditors, potential investors in reorganizing entities have always relied upon the fact that no court has ever reversed an unstayed order confirming a substantially consummated plan of reorganization. Issuance of the writ in this case has undermined that justifiable reliance. The adverse consequences for creditors are self-evident. "People pay less for assets that may be snatched back . . . ." *In the Matter of UNR Industries, Inc.*, 20 F.3d 766, 771 (7th Cir. 1994).

Moreover, frivolous appeals from such unstayed orders have been discouraged by the certainty of dismissal. Issuance of the writ in this case has removed the barrier to such appeals, encouraging blackmail by parties with

insignificant claims or interests who threaten to bring reorganizations to a halt by appealing confirmation of a plan of reorganization.[1]

In support of this Motion, Respondent incorporates by reference the argument and authority contained at pages 9 through 15 of its Response in Opposition to the Petition for Writ of Certiorari. Petitioner replied to that argument and substantial authority supporting it only by mischaracterizing Respondent's resistance to issuance of the writ as an attempt to alter the judgment below, and by incorrectly suggesting that the relief sought by Respondent required alteration of factual findings by lower courts. In fact, Respondent does not seek to disturb the judgments of the lower courts, but merely opposes the issuance of a writ of certiorari. Furthermore, Respondent never asserted that this Court should review the lower courts' factual findings. Instead, Respondent argued that, based upon those facts, especially good faith reliance by investors on the unstayed confirmation order, it is no longer *prudent* for this Court to grant relief that would cause recission of previously consummated transactions. Rather than cite any authority in response to the numerous well-reasoned cases relied upon by Respondent in its brief, Petitioner merely dismisses as "preposterous" Respondent's contention that consideration of this case on the merits will cast doubt on finality of confirmation orders. Reply Brief for Petitioner at 4-8.

[1] "A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter [Chapter 11]." 11 U.S.C. § 1109(b). Therefore, a creditor holding a claim, no matter how small, and a shareholder holding a single share of stock has standing to appeal.

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BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, SUCCESSOR BY MERGER TO BANK OF AMERICA ILLINOIS,

Petitioner,

v.

203 NORTH LaSALLE STREET PARTNERSHIP,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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QUESTION PRESENTED

Does 11 U.S.C. Section 1129(b)(2)(B)(ii) prevent confirmation of a plan of reorganization under the terms of which all of the reorganization value of the insolvent debtor has been given to creditors, simply because old equity holders retained an interest in the entity for which they paid fair equivalent value?

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

STATEMENT 1

I. Introduction 1

II. Factual Background 3

SUMMARY OF ARGUMENT 8

ARGUMENT 12

I. The Plan Satisfies the Plain Language of Section 1129(b)(2)(B)(ii) 12

A. "On account of," in the context of Section 1129(b)(2)(B)(ii), means "in consideration for" or "in exchange for." 12

B. The only *property* which Investors received or retained *under the Plan* was the equity interest they purchased with $6.125 million of new value 22

II. The New Value Corollary has been an established part of reorganization practice since 1869 29

III. When Congress enacted the Code, it understood that the New Value Corollary was an established part of reorganization practice and of the absolute priority rule 37

TABLE OF CONTENTS – Continued

Page

IV. Variances between the Bankruptcy Act and the Code have no effect on the meaning of "fair and equitable." 38

V. The New Value Corollary is consistent with Bankruptcy Code policies 40

A. The new value plan in this case maximized value for *all* creditors 40

B. The New Value Corollary does not improperly deprive creditors of "control" 43

C. Judicial fallibility is no reason to ignore the plain language of the Code 47

VI. Conclusion 49

TABLE OF AUTHORITIES

Page

CASES

In re American Trailer Rentals Company, 325 F.2d 47 (10th Cir. 1963) 34

Associates Commercial Corp. v. Rash, 520 U.S. 953 (1997) 40, 48

BFP v. Resolution Trust Corp., 511 U.S. 531 (1994) 21

In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1994), *cert. dismissed*, 513 U.S. 18 (1994) ..... *passim*

Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) ..... *passim*

Chicago Rock Island & Pac. R.R. v. Howard, 74 U.S. (7 Wall) 392 (1869) 31, 32

Consolidated Rock Prods. Co. v. DuBois, 312 U.S. 510 (1941) 24, 33, 48, 49

Dewsnup v. Timm, 502 U.S. 410 (1992) 30

General Stores Corporation v. Shlensky, 350 U.S. 462 (1956) 33

In re Handy Andy Home Improvement Cntrs., Inc., 144 F.3d 1125 (7th Cir. 1998) 13

In re Integrated Resources, Inc., 135 B.R. 746 (Bankr. S.D.N.Y.), *aff'd*, 147 B.R. 650 (S.D.N.Y. 1992), *appeal dismissed on jurisdictional grounds*, 3 F.3d 49 (2nd Cir. 1993) 29

Jameson v. Guaranty Trust Co. of New York, 20 F.2d 808 (7th Cir. 1927) 33

Kansas City Terminal Ry. Co. v. Central Union Trust Co., 271 U.S. 445 (1926) ..... *passim*

TABLE OF AUTHORITIES – Continued

Page

Kansas City Terminal Ry. Co. v. Central Union Trust Co., 28 F.2d 177 (8th Cir. 1928) 19, 33

Keech v. Stowe-Fuller Co., 205 F. 887 (6th Cir. 1913) 33

Kelly v. Robinson, 479 U.S. 36 (1986) 17

Lanasa Fruit Steamship & Importing Co. v. Universal Ins. Co., 302 U.S. 556 (1938) 20

Marine Harbor Properties, Inc. v. Manufacturer's Trust Company, 317 U.S. 78 (1942) 32, 33

Mason v. Paradise Irrigation Dist., 326 U.S. 536 (1946) 33, 34

In re Moonraker Associates, Ltd., 200 B.R. 950 (Bankr. N.D. Ga. 1996) 21

Movitz v. First National Bank, 1998 U.S. App. LEXIS 13379 (7th Cir. June 23, 1998) 20

In re Muskegon Motor Specialties, 366 F.2d 522 (6th Cir. 1966) 34

Northern Pac. Ry. Co. v. Boyd, 228 U.S. 482 (1913) *passim*

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) ..... *passim*

Oehring v. Fox Typewriter Co., 272 F. 833 (6th Cir. 1921) 33

O'Gilvie v. United States, 519 U.S. 79 (1996) ... 14, 19, 20

Palmer v. Banker's Trust Co., 12 F.2d 747 (8th Cir. 1926) 33

Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552 (1990) 23

TABLE OF AUTHORITIES – Continued

Page

In re Potter Material Service, Inc., 781 F.2d 99 (7th Cir. 1986) 34

Reese v. United States, 24 F.3rd 228 (Fed. Cir. 1994) 15

In re Sandy Ridge Development Corp., 881 F.2d 1346 (5th Cir. 1989) 5

In re Snyder, 967 F.2d 1126 (7th Cir. 1992) 31

Spitzer v. Stichman, 278 F.2d 402 (2d Cir. 1960) 34

Textron Lycoming Reciprocating Engine Division v. UAW, ___ U.S. ___, 118 S. Ct. 1626, 140 L.Ed.2d 863 (1998) 13

Toibb v. Radloff, 501 U.S. 157 (1991) 40

In re U.S. Truck Co., 800 F.2d 581 (6th Cir. 1986) 34, 45

Union Bank v. Wolas, 502 U.S. 151 (1991) 40

United Savings v. Timbers of Inwood Forest, 484 U.S. 365 (1988) 40, 43, 44

United States v. Nordic Village, Inc., 503 U.S. 30 (1992) 23

United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) 1, 3, 40

In re Universal Lubricating Sys., 71 F. Supp. 775 (W.D. Pa. 1947) 34

In re W.A. Mallory Co., Inc., 214 B.R. 834 (Bankr. E.D. Va. 1997) 49

In re Woodbrook Associates, 19 F.3d 312 (7th Cir. 1994) 6, 46

TABLE OF AUTHORITIES – Continued

Page

STATUTES AND RULES

11 U.S.C. §§ 101 *et seq.* 1

11 U.S.C. § 101(40) 47

11 U.S.C. § 101(51)(B) 27

11 U.S.C. § 102(3) 1, 18

11 U.S.C. § 205(e)(1934) (repealed) 17

11 U.S.C. § 362 27

11 U.S.C. § 362(d)(2)(A) 48

11 U.S.C. § 362(d)(3) 27

11 U.S.C. § 363 ..... 48, 49

11 U.S.C. § 363(b) 49

11 U.S.C. § 506(a) 5, 41, 48

11 U.S.C. § 548(a)(2) 30

11 U.S.C. § 548(a)(2)(A) 48

11 U.S.C. § 621(2) (1970) (Repealed) 17, 32

11 U.S.C. § 901 47

11 U.S.C. § 1109 ..... 1, 21

11 U.S.C. § 1111(b) 2, 41

11 U.S.C. § 1111(b)(1)(A) 4

11 U.S.C. § 1111(b)(2) 5, 41, 42

11 U.S.C. § 1121 ..... 26, 27

11 U.S.C. § 1121(b) 1, 7

TABLE OF AUTHORITIES – Continued

Page

11 U.S.C. § 1121(d) 1, 28
11 U.S.C. § 1123(a)(5)(J) 1, 28
11 U.S.C. § 1129 2
11 U.S.C. § 1129(a) 2
11 U.S.C. § 1129(a)(7)(A)(ii) 49
11 U.S.C. § 1129(a)(7)(A)(ii)(B) 15
11 U.S.C. § 1129(a)(8) 2
11 U.S.C. § 1129(a)(9)(A) 15
11 U.S.C. § 1129(a)(9)(C) 15
11 U.S.C. § 1129(a)(11) 28
11 U.S.C. § 1129(b) ..... *passim*
11 U.S.C. § 1129(b)(1) ..... *passim*
11 U.S.C. § 1129(b)(2) 18
11 U.S.C. § 1129(b)(2)(A)(i) 6
11 U.S.C. § 1129(b)(2)(A)(i)(II) 15
11 U.S.C. § 1129(b)(2)(B)(i) 15, 48
11 U.S.C. § 1129(b)(2)(B)(ii) ..... *passim*
11 U.S.C. § 1129(b)(2)(C)(i) 15
11 U.S.C. § 1129(b)(2)(C)(ii) 15
11 U.S.C. § 1129(c) 29
11 U.S.C. § 1141 ..... 23, 28
12 U.S.C. § 29 4

TABLE OF AUTHORITIES – Continued

Page

Federal Rules of Bankruptcy Procedure, Rule 2002(d)(6) 21

Federal Rules of Bankruptcy Procedure, Rule 3012 5

Federal Rules of Bankruptcy Procedure, Rule 8013 22

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TABLE OF AUTHORITIES – Continued

Page

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STATEMENT

I. Introduction

Fundamentally, a plan of reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C. §§ 101 *et seq.)* effectuates an *exchange* of old pre-petition claims and interests for new rights under a confirmed plan.[1] A plan must "provide adequate means for the plan's implementation, such as – issuance of securities . . . *for cash*, for property, for existing securities, *in exchange for claims or interests*, or for any other appropriate purpose." Section 1123(a)(5)(J) (emphasis added). There is nothing in the Code which dictates or restricts the source of funding for a plan.[2] Reorganization benefits creditors by preserving or creating value that would not otherwise be available in a foreclosure or forced liquidation. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983).

The Code gives the debtor the exclusive right to propose a plan during the first 120 days of the case. Section 1121(b). Parties in interest may show cause to reduce or increase that exclusive period.[3] Section 1121(d). The role of the bankruptcy court in the plan confirmation

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[1] Hereafter, unless otherwise noted, all Section references will be to the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq. ("Code")*. "Pet. Br." refers to Petitioner's brief on the merits. "SG Br." refers to the brief of the Solicitor General as amicus curiae. "Pet. App." refers to the Appendix to Petitioner's Petition for Issuance of a Writ of Certiorari. "J.A." refers to the Joint Appendix.

[2] In this case, the Debtor's plan of reorganization (the "Plan") was funded by a capital call on the Debtor's partners.

[3] Parties in interest are defined in Section 1109 as "including" the debtor, the trustee, a creditors' committee, an equity security holder or an indenture trustee. Section 102(3) provides that "includes" and "including" are not limiting.

process is clearly set forth in Section 1129. Relevant to the issue in this case – the interpretation of Section 1129(b)(2)(B)(ii) – the Code restricts the bankruptcy judge's role to resolving conflicts between classes of creditors which have voted to accept the proposed plan and classes of creditors which have voted to reject the proposed plan.

In this case there was such a conflict. Two impaired classes of unsecured creditors disagreed over the Plan. One class of unsecured trade creditors voted to accept the Plan; the other, the class whose only member – the Petitioner ("Bank") – held an artificially created unsecured claim which existed only by virtue of Section 1111(b), voted to reject.

When classes disagree over whether to accept a plan, the Code *requires* the bankruptcy court to resolve the conflict and confirm the plan, if all of the requirements of Section 1129(a), other than Section 1129(a)(8) (requiring that each impaired class accept the plan) have been satisfied, and if the plan is "fair and equitable" with respect to the dissenting class. Section 1129(b)(1).[4] The plain language of the Bankruptcy Code prevents the dissenting class from depriving assenting creditors of the substantial benefits which may flow from a reorganization. The statutory mandate that the bankruptcy court override the vote of a dissenting class and confirm such a plan is known as "cramdown."

The statutory mandate to "cramdown" a plan upon dissenting classes of unsecured creditors, which the court

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[4] There is nothing in the Code which requires or permits the court to consider the number or amount of claims in the dissenting class, relative to the number or amount of claims in the assenting class, in determining whether a plan is "fair and equitable".

determines to have been treated "fairly and equitably," *requires* the bankruptcy court to second guess dissenting creditors' judgment. Section 1129(b) requires the bankruptcy court (rather than one of the parties to the dispute) to adjudicate the controversy and to use Section 1129(b) as its standard. A dissenting class, whose rights in an insolvent debtor's assets have been protected relative to subordinate rights of junior classes, has no right to "spoil the party" for assenting classes of creditors.

It is abundantly clear that the slogans scattered throughout the briefs of the Bank and its amici are oversimplifications which are patently inconsistent with the plain language of the Code.[5] Congress has explicitly directed the bankruptcy judge to bind dissenting creditors, whom the judge determines have been treated fairly and equitably, to a plan of reorganization. Any holding which has the effect of disrupting that coherent statutory scheme would be judicial legislation.

II. Factual Background

The Plan, which has been in effect since December 6, 1995, gives the Bank all of the cash flow and future

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[5] Examples of such slogans are: "Creditors effectively own bankrupt firms . . . and whether creditors would be better off under a proposed plan of reorganization is a determination . . . for creditors to make." (Pet. Br. at 41-2 (internal quotation marks omitted).); and "The new value exception also improperly injects the judiciary into what should be creditors' business decisions. . . . The new value exception reverses the roles of creditors and courts." (Pet. Br. at 44.) With respect to the slogan that creditors effectively own bankrupt debtors, *see Whiting Pools*, 462 U.S. at 211 (Case involving the Internal Revenue Service as a secured creditor holding a tax lien in which the Court held, that until a transfer of ownership at a tax foreclosure sale is complete, the property remains the debtor's.).

appreciation from the reorganized debtor's ("Reorganized LaSalle") office building (the "Property") until the Bank has received payment in full of its secured and unsecured claims, aggregating $93 million.[6] The Bank's opportunity to benefit from that future appreciation, which the Bank agrees will occur, is facilitated by a $6.125 million new capital contribution from certain of the former Debtor's partners ("Investors"). The Plan provides that the Investors can receive no return whatsoever on or of their investment until the Bank has been paid in full. The Investors made the new capital contribution to defer the tax liability they would have incurred if the Bank had foreclosed on its mortgage.[7] (Pet. App. at 112a-113a.)

The Bank's note was nonrecourse, requiring the Bank, under nonbankruptcy law, to look only to the Property for payment. Therefore, in a foreclosure, the Bank would have received only the depressed value of the Property at the time of the foreclosure sale.[8] In a Chapter 7 liquidation, the Bank's deficiency claim would have been disallowed as unenforceable under applicable nonbankruptcy law. (Pet. App. at 128a.) However, in this Chapter 11 case, pursuant to Section 1111(b)(1)(A), the

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[6] As described below, the Plan preserves the Bank's deficiency claim in its entirety until that claim has been paid in full. Since the effective date of confirmation of the Plan, the principal amount of the secured loan has been paid down by over $5 million.

[7] The Plan eliminated the interests of non-contributing partners. Partners who did contribute new capital received equity interests in Reorganized LaSalle proportionate to their contributions. Over sixty percent of the partnership interests changed hands upon confirmation of the Plan.

[8] Federal banking law requires banks to dispose of saleable foreclosed properties within five years. 12 U.S.C. § 29.

Bank was entitled to be treated as if it had recourse against the Debtor. The Bank had a right, under Section 1111(b)(2), to retain a lien upon the Property for its full $93 million claim. But for tactical reasons, the Bank chose not to exercise that right.[9] As a result of the Bank's choice, under Section 506(a) and Bankruptcy Rule 3012, the Bank's claim was split into two claims: (a) a secured claim equal in amount to the value of the Property and (b) an artificially created unsecured deficiency claim for the balance of the Bank's loan. In order to determine the amount of the Bank's secured claim, the bankruptcy court was *required* to value the Property. *In re Sandy Ridge Development Corp.*, 881 F.2d 1346, 1354 (5th Cir. 1989) ("Although we recognize that property valuation is not an exact science, it remains an integral part of the bankruptcy process."). The Bank's $54.5 million secured claim was based on the bankruptcy court's valuation of the Property at $55.8 million, less the disposition costs which the Bank would have incurred if it had sold the Property after foreclosing on its mortgage. (Pet. App. at 115a.) *There was no material difference between the Bank's and the*

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[9] Obviously, the Bank, a secured creditor, made that choice to permit it to cloak itself in unsecured creditor's clothing with standing to invoke Section 1129(b)(2)(B)(ii). Under the circumstances, it is cynical for the Bank to represent that unsecured creditors have decided their own financial interests by a majority vote. It is significant that neither the Bank nor any of its amici really represent the interests of genuine unsecured creditors. The actual interests of real unsecured creditors are represented in this case by the amicus briefs of the National Association of Credit Management and the twenty regional Credit Associations who have joined as amici with the Commercial Investment Real Estate Institute, the National Apartment Association, and National Small Business United filed in support of Respondent.

bankruptcy court's valuation of the Property. The bankruptcy court's value for the Property was a mere 2.8% less than the value proposed by the Bank's appraiser. (Pet. App. at 108a, 111a.)

General Electric Capital Corporation ("GE"), in a letter of intent for refinancing the Property, offered to lend Reorganized LaSalle $54.5 million with which to immediately pay the Bank's secured claim in cash, in full. (Pet. App. at 125a-126a.) The Bank refused to accept that cash payment, or any plan which would have permitted the Debtor to retain ownership of the Property. (Pet. App. at 126a.) Therefore, in order to confirm its Plan, the Court was required to "cramdown" the Plan on classes containing the Bank's secured and unsecured claims by satisfying the requirements of Sections 1129(b)(2)(A)(i) and 1129(b)(2)(B)(ii).

The Plan treated the Bank's secured claim more favorably than the treatment required by the market place as evidenced by GE's letter of intent. Thus, although the Bank voted its secured claim to reject the Plan, the bankruptcy court found that the Plan's treatment of that claim satisfied the requirements of Section 1129(b)(2)(A)(i).[10] (Pet. App. at 172a.)

As required by the Seventh Circuit's decision in *In re Woodbrook Associates*, 19 F.3d 312, 319 (7th Cir. 1994), the Plan placed the Bank's artificial deficiency claim in a class by itself. Under the Plan, the Bank's artificial deficiency claim receives all proceeds from a sale or refinancing of the Property remaining after payment of the Bank's secured claim, until that deficiency claim is paid in full. (Pet. App. at 132a-133a.) The bankruptcy court projected that a sale or refinancing of the Property on the tenth

[10] The Bank has not appealed that finding to this Court.

anniversary of plan confirmation would produce a $19 million distribution to the Bank on account of its deficiency claim, representing a 16% dividend on a present value basis. (Pet. App. at 133a.) If the Property is refinanced rather than sold on or before the tenth anniversary of confirmation of the Plan, the potential exists for the Bank to receive an even greater dividend when the Property is refinanced again or sold after the tenth anniversary of Plan confirmation.[11]

The Bank was not the only creditor in this case. General unsecured trade debt of about $160,000, held by forty five creditors, was paid in full pursuant to the Plan. (Pet. App. at 103a, 132a.) The general partner of the Debtor and an affiliate held additional unsecured claims, allowed by the bankruptcy court, totaling $7.7 million; the general partner held another claim secured by a $11.3 million second mortgage. (Pet. App. at 103a, 129a.) Under the Plan, the general partner and its affiliate waived their unsecured claims, even though the $7.7 million of unsecured claims held by the general partner and its affiliate would have received a distribution of approximately $3 million under Chapter 7. (Pet. App. at 129a-130a.) Under the Plan, that money was reinvested in the Property. The Plan fully subordinated the new capital contribution to the Bank's artificial deficiency claim. (Pet. App. at 135a.)

Prior to confirmation of the Plan, the Bank filed a motion in the bankruptcy court seeking to terminate the Debtor's statutory exclusive right under Section 1121(b)

[11] The Plan does not reduce the Bank's deficiency claim. Thus, if the first mortgage is paid through successive refinancings, the deficiency will continue to exist and the potential exists for the Bank to benefit from those refinancings until its deficiency claim is paid in full.

to file a plan. The Bank also sought leave to file its own plan that called for liquidation of the Property, and made no provision either for contribution of new capital or for any payment to the $7.7 million of allowed unsecured claims held by insiders. The bankruptcy court denied the Bank's motion. The Bank did not appeal that denial or raise that denial as an issue on appeal.

Following confirmation of the Plan, the Bank moved both in the bankruptcy court and in the district court for a stay pending appeal. (J.A. at 7, 12.) The Bank refused to post a supersedeas bond. (J.A. at 8, 13.) As a result, its motions for stay pending appeal were denied and the Plan was implemented.

SUMMARY OF ARGUMENT

The Plan in this case satisfied the plain language of Section 1129(b)(2)(B)(ii). That section provides that the holder of a junior claim or interest may not, over the dissent of a class of senior interests, "receive or retain under the plan on account of such junior claim or interest any property." This is the so-called absolute priority rule *and* its new value corollary. By its very terms, Section 1129(b)(2)(B)(ii) does not prohibit a reorganization plan from providing that the holders of junior interests – such as the Investors here – purchase an interest in the reorganized entity. The absolute priority rule states only that if a senior class dissents, the owners may not receive this interest "on account of" their junior interest.

Here, the Investors did not receive any property under the plan "on account of" their junior interest in the debtor. They received their interest in Reorganized LaSalle "on account of" – that is, in exchange for – their payment of $6.125 million in cash. Under the Plan, only partners who paid cash received "property" in the reorganized

firm. Partners who did not pay – and there were many – received no property at all, and their interest was wiped out.

The Bank refers repeatedly to the "new value exception" and trumpets that the Code contains no such "exception." This argument, so prominent in the Bank's brief, is a red herring. It is part of the Bank's sustained effort to divert the Court's attention from the plain language in Section 1129(b)(2)(B)(ii) – such as the phrase "on account of" – an effort that fatally undermines the Bank's position.

We fully agree that there is no exception to the absolute priority rule – the court of appeals did not create one, and we do not seek one. The absolute priority rule itself, by its terms, simply does not apply to a reorganization plan when the old equity holders receive their interest in the new firm in exchange for – "on account of" – their payment of new value. That is what occurred here. Solicitor General Robert Jackson – taking a position that, as we explain below (see pages 35-36), his successor inexplicably abandoned 59 years later – referred to a new value "corollary" to make this point about the absolute priority rule, and for convenience we use Solicitor General Jackson's term. But the term "new value corollary" should not be taken to suggest that our position requires anything other than a literal application of the language of Section 1129(b)(2)(B)(ii). Similarly, the Bank tries to create the impression that the new value corollary was invented by a dictum in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 119-121 (1939).[12] This, too, is false. This Court has recognized for at least eighty-five years –

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[12] The Bank argues that the Court's recognition of the corollary in *Case* is *dicta*, because it was allegedly unnecessary to the decision. (Pet. Br. 33-34.) But, there would have been no need to address the requirements of the corollary in *Case*, if the corollary did not exist.

since *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482 (1913) – that the absolute priority rule is not violated when equity holders retain an interest in exchange for payments of cash. The *holding* of *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926), is that a plan containing such a feature is valid. The dictum in *Case* that so preoccupies the Bank referred to an aspect of bankruptcy law that was already well established at the time of *Case*.

The Bank's position, in short, would require the Court *both* to read the phrase "on account of" out of the statute – or give that phrase an implausible meaning – *and* to discard an approach that has been an accepted part of bankruptcy law for eight decades. Nothing that the Bank or its amici say remotely justifies such a drastic step.

The Bank's brief conspicuously strains to avoid having to come to grips with the phrase "on account of" – a phrase that the Bank never even defines. Instead the Bank places inordinate emphasis on the argument that the Plan provides for the prospective investors to receive "property," for which they did not pay.

The Plan obviously does provide that the Investors will receive property: they will receive an interest in the reorganized firm. But the Bank, bizarrely, insists that "the purchased equity interest" is *not* "the property interest provided by the plan" (Pet. Br. at 20.) – even though, of course, the Plan provides precisely that the investors will "receive" (in the language of Section 1129(b)(2)(B)(ii)) a "purchased equity interest." The reason the Bank tries to ignore this "property" is apparent. This is, in the Bank's own revealing words, a "*purchased*" equity interest: the investors received this property because they purchased

it for new value; they received it "on account of" their contribution of $6.125 million in cash.

Instead of focusing on the purchased property that the Plan really *does* distribute – a focus that would reveal the utter weakness of the Bank's position – the Bank tries to change the subject to a chimerical form of property that the old partners do *not* receive under the Plan. The Bank asserts, repeatedly, that the Plan gives the old partners "the exclusive opportunity to retain an equity interest in [the] business enterprise." (Pet. Br. at 15.) But the Plan did not give the old partners an "opportunity" or option in any form. The Plan *required* that they pay $6.125 million, in exchange for which those who invested received an interest in the reorganized firm. Once the Plan was approved by the bankruptcy judge, the Investors had no options or opportunities whatsoever: they faced a $6.125 million liability.

Casting aside the language of Section 1129(b)(2)(B)(ii), the Bank repeatedly insists that the Investors here received "special treatment" on account of "their status." (Pet. Br. at 20, 21.) But the "special treatment" that the Bank inveighs against is the debtor's exclusive right to propose a plan during the first 120 days. That right is specifically provided for in the statute. Section 1121. The "property" that the investors received "under the plan" was property for which they paid.

The Code made no change to the substance of the "fair and equitable" rule when it codified the "fixed principle" of *Boyd*, as interpreted in *Kansas City Terminal*. The Code merely changed the standing requirement of the party in interest who could invoke the absolute priority rule from a dissenting individual (under the Act) to a dissenting class. The content of the rule remained the same.

The new value corollary is consistent with the purpose of Chapter 11, which is to maximize realizable value of the assets of a Chapter 11 debtor for all of its creditors. It has never been the law, either under the Code or previous reorganization law, that a non-assenting creditor, such as the Bank, has complete veto power over a reorganization. Moreover, the fact that judges may not always perfectly perform their statutory valuation duties under the Code, does not justify ignoring the Code's clear requirement that the bankruptcy judge value collateral for "cramdown" purposes.

ARGUMENT

I. The Plan Satisfies the Plain Language of Section 1129(b)(2)(B)(ii).

A. "On account of," in the context of Section 1129(b)(2)(B)(ii), means "in consideration for" or "in exchange for."

A key phrase in Section 1129(b)(2)(B)(ii) is "on account of." For the reasons set forth below, that phrase means "in consideration for," or "in exchange for." As explained above, reorganization involves an exchange of old pre-petition claims and interests for new rights under a confirmed plan. In this case, creditors paid for the property they received under the Plan by exchanging their pre-petition debt for that property. In contrast, pre-petition partners were not permitted to pay for their retained interests by exchanging their pre-petition partnership interests. The Plan specifically provides:

> The partnership interest . . . of any partner who fails to make the foregoing required contribution or any part thereof, *shall automatically be deemed terminated*.

(J.A. at 39 (emphasis added).) Accordingly, the equity interests of pre-petition partners who did not respond to the capital call were wiped out. In the Bank's own words, Investors "purchased" (Pet. Br. at 20.) the interests which they retained under the confirmed Plan with $6.125 million in fresh cash.

The Oxford English Dictionary, 2d edition (1989), states that the phrase "on account of" is derived from the business phrase "on account", which means, "as an item to be accounted for at the final settlement, in anticipation of or as a contribution to final payment, as an interim payment on account of something in process." That dictionary defines "on account of" as "in consideration of, for the sake of, by reason of, because of." "In consideration of" is listed as the first definition of "on account of" in deference to the expressly mercantile origins of the phrase. A reorganization plan, of course, itself speaks the language of a business exchange – classes of creditors and equity holders are offered something in exchange for their pre-petition claims and interests. For this reason, the most natural meaning for "on account of" in the context of Chapter 11 is, "in consideration of", "in exchange for" or, if you will, "in satisfaction of."[13] Moreover, this meaning affords guidance to courts in interpreting the statute.

The Bank's arguments that the Plan violates Section 1129(b)(2)(B)(ii) are flawed because they ascribe an unnatural and unworkable meaning to that phrase, by

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[13] The Court recognizes that statutory language, like other language, should be read in context. *Textron Lycoming Reciprocating Engine Division v. UAW*, ___ U.S. ___, 118 S. Ct. 1626, 1629, 140 L.Ed.2d 863 (1998). Context consists not merely of other sentences, but also of the real world situation to which the language pertains. *In re Handy Andy Home Improvement Cntrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998).

requiring application of a "but for" causation test. The Bank's "because of" reading fails to reflect the reality of the exchange which occurs in a reorganization. Requiring application of a causation test leads to arguments about "degrees of causation" which simply cannot be what Congress intended. Congress could not possibly have meant the application of the absolute priority rule to turn on a vague and formless Aristotelian inquiry, exemplified at Pet. Br. pp. 21-22, into whether the equity holders' prior interest was the "cause" of their retention of equity in Reorganized LaSalle. However, even if the phrase implies causation, "proximate cause" is the proper test. Properly interpreted, the Investors retained no property under the Plan "on account of" their pre-petition equity interests.

One searches the Bank's brief in vain for a definition of "on account of" – the phrase which is the pivot upon which the Bank's whole argument turns. The Bank assumes, without discussion, that the phrase requires a "but for" causation inquiry. The Solicitor General (SG Br. at 11-12) explicitly states that the phrase means "for," "because of" and "by reason of," thereby also ascribing a "but for" meaning to that phrase.[14] But, at the urging of the Solicitor General, the Court recently refused to ascribe a "but for" meaning to the phrase "on account of" in the Internal Revenue Code, instead adopting an interpretation of those words that "impose[s] a *stronger causal connection*." *O'Gilvie v. United States*, 519 U.S. 79 (1996)

[14] The Solicitor General also explains away "on account of" as a Congressional attempt to make clear that junior creditors who also have senior claims can receive property "on account of" their senior claims. (SG Br. at 15) Surely, if that is what Congress intended, it would have expressly said so, and there would be some reference to that intent in the legislative history.

(emphasis added).[15] The underlined words of the Court in *O'Gilvie* are almost identical to the underlined phrase used by the Seventh Circuit, in this case: "Congress, in using the 'on account of' language, might well have intended *a more direct causation*. . . . [than that urged by the Bank]" (Pet. App. at 17a (emphasis added).) *See also, In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1994), *cert. dismissed*, 513 U.S. 18 (1994) ("A reading of the full text of section 1129(b)(2)(B)(ii) makes it clear that what Congress had in mind was a direct or immediate causation rather than a more remote variety. . . . ").[16] Explicitly defining "on account of" to mean "but for" causation leads the Solicitor General, as it must, to a conclusion which is too rich even for the Bank's blood – that equity holders can *never* have an interest in a reorganized debtor over the dissent of a class of senior creditors which is not being paid in full.[17] Recognizing how

[15] In his brief in that case, using the same dictionary definition as he used in this case, the Solicitor General urged the Court to reject a "but for causation approach" and cited the following language from *Reese v. United States*, 24 F.3d 228, 230 (Fed. Cir. 1994) with approval in support of his position: "[t]he language 'on account of' is not free of ambiguity; rather it is susceptible of *at least* two conflicting interpretations." 1996 Westlaw 325323 at 16 (emphasis added). In that brief, the Solicitor General argued that "sufficient" [or proximate] cause is the proper interpretation of "on account of." *Id.* at 17.

[16] The phrase "on account of" is peppered throughout the Code. The phrase can be properly defined only in the context of the section in which it is used. Every time the phrase is used in Section 1129, its most natural meaning is "in exchange for." 1129(a)(7)(A)(ii)(B); 1129(a)(9)(A); 1129(a)(9)(C); 1129(b)(2)(A)(i)(II); 1129(b)(2)(B)(i); 1129(b)(2)(B)(ii); 1129(b)(2)(C)(i) and 1129(b)(2)(C)(ii).

[17] That prohibition would, of course, apply as well to retention of any interest by junior creditors, such as subordinated debenture holders.

radical that view is, the Bank distances itself from the Solicitor General by pointing out (Pet. Br. at 11) that the Court is not required to address the Solicitor General's argument.[18] If the meaning of "on account of" in Section 1129(b)(2)(B)(ii) were as clear as the Bank would have the Court believe, surely the Bank and its amici would be able to agree on the consequences of that language.

The Solicitor General candidly acknowledges the inevitable consequences of ascribing a "but for" meaning to "on account of," i.e. junior claim and interest holders can *never* participate in a reorganized debtor over the objection of a class of unpaid senior unsecured creditors. That conclusion is inescapable, because possession of a pre-petition claim or interest will always, no matter how remote, be a link in the chain of causation leading back from participation in the reorganized entity. But, adopting the Solicitor General's interpretation would require the Court to overrule its seminal cases which established the existence and contours of the absolute priority rule: *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482 (1913) and *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).[19]

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[18] The same arguments were made by previous Solicitors General in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) and *Bonner Mall*, 2 F.3d at 899.

[19] The Bank and the Solicitor General attempt to escape this conclusion by mis-characterizing *Kansas City Terminal* as a case where senior (i.e. *secured*) creditors consented to old equity's continued participation. That consent was irrelevant to the Court's decision, which approved old equity's participation in exchange for a contribution of necessary new capital over *unsecured* creditors' dissent.

No reason is given why the Court should overrule those cases, which constitute the bedrock of reorganization law. Surely if Congress had intended to overrule those cases, by the oblique method of ascribing a "but for" causation meaning to the commercial term "on account of," some mention of that intention and those cases would have appeared in the legislative history. *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) (When Congress intends to change the interpretation of a judicially created concept, it makes that intent specific.)

In *Boyd*, the Court recognized that old equity holders could participate in a reorganized entity over the objection of an unpaid unsecured creditor by making a "fair offer." *Boyd*, 228 U.S. at 508. In *Kansas City Terminal*, the Court defined an offer as "fair" if it involved a *cash* contribution from old equity holders which was essential to success of the reorganization.[20] 271 U.S. at 455.

This Court has held that the phrase "fair and equitable," "is a term of art used to indicate that a plan fulfills the necessary standards of fairness." *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 118 (1939). The Court recognized that those standards were established, *inter alia*, in *Boyd* and *Kansas City Terminal*. *Id.* at 115. Adoption of the rule advocated by the Solicitor General would fundamentally alter the meaning of the phrase "fair and equitable," as Congress used that phrase both in Section 1129(b)(1), and in the predecessors to that Section, Section 221(2) of Chapter X, 11 U.S.C. § 621(2) (1970) (repealed) and Section 77B(f), 11 U.S.C. § 205(e) (1934) (repealed). Neither the Bank nor the Solicitor General has

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[20] By requiring that the "fair offer" be an offer of cash, the Court reaffirmed its ruling in *Boyd* and ruled that so called "give-up" plans were not "fair offers."

suggested any valid reason why this Court should usurp the role of Congress and legislate a radical change in the meaning which Congress has ascribed to the phrase "fair and equitable" for nearly 65 years.

The Solicitor General is incorrect when he states (SG Br. at 22-23) that the meaning ascribed by the Court of Appeals to the phrase "on account of" would allow for "give up" plans.[21] This error results from misunderstanding the relationship between Section 1129(b)(2)(B)(ii) and use of the term "fair and equitable" in Section 1129(b)(1).

Section 1129(b)(1) provides that a cramdown plan must be confirmed if it is "fair and equitable" with respect to impaired dissenting classes. Section 1129(b)(2) goes on to provide, "the condition that a plan be fair and equitable *includes* the following requirements." (emphasis added) Section 102(3) states that " 'includes' and 'including' are not limiting."[22] Section 1129(b)(2)(B)(ii) describes only one set of circumstances which will *prevent* a finding

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[21] The Solicitor General's definition of a "give up" plan (SG Br. at 22) is incomplete. The definition omits the crucial element of a "give up" plan, which is that the junior class to which property was allocated by senior claim holders did not pay fair equivalent value for the interest received. The interest was "given up" to them as a gift by senior claim holders. The Solicitor General used this tactic to avoid the precedential effect of the *Kansas City Terminal* decision, which approved a new value cramdown plan.

[22] The legislative history of Section 1129(b) reveals that many well-settled aspects of the fair and equitable requirement, e.g. the rule that creditors in a senior class not receive more than 100 percent of their claims, were omitted from Section 1129(b)(2) merely to avoid unnecessary complexity, and not to effect any change in the substance of the rule itself. 124 CONG. REC. 32,407 (1978) (statement of Rep. Edwards); *Id.* at 34,006 (1978) (statement of Sen. DeConcini).

that a plan of reorganization is "fair and equitable" with respect to a class of dissenting unsecured claims. In other words, the "fair and equitable" requirement of Section 1129(b)(1) is broader than the prohibition of Section 1129(b)(2)(B)(ii). Accordingly, since "give up" plans have been prohibited since *Boyd*, because they were held not to be "fair," they are also prohibited as "unfair" under Section 1129(b)(1), irrespective of whether such plans pass muster under Section 1129(b)(2)(B)(ii).

Moreover, the Solicitor General's description of *Kansas City Terminal* as a "give up plan" (SG Br. at 23 n. 24) is inaccurate. In *Kansas City Terminal*, senior creditors did not "give up" or gift a portion of their value to former equity holders. Old equity paid cash in exchange for its participation in the reorganized entity. *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 28 F.2d 177, 187 (8th Cir. 1928) (after remand from the Supreme Court). The Court ruled that the plan satisfied the "fixed principle" of *Boyd*, and was fair and equitable with respect to dissenting unsecured creditors who were not paid in full.

Even if the Court should conclude that "on account of" means only "because of," the Court should interpret that phrase to require application of a proximate, direct cause test, and should not be led astray into the metaphysical maze of the "but for" inquiry advocated by the Bank. The Courts of Appeals in this case and in *Bonner Mall*, 2 F.3d at 909, correctly opted for a direct, or proximate, cause interpretation of "on account of."

Courts do not use "but for" causation as a sufficient basis to determine legal consequences. *O'Gilvie*, 519 U.S. at 79. As Chief Judge Posner wrote:

> . . . a finding of 'but for' causation (what philosophers call a 'necessary condition') is not a sufficient basis for imposing legal liability. If it were, then the estates of Santa Anna, Sam

> Houston, or Columbus might also be liable to Estock [Plaintiff], plus the inventor of the steel girder . . .

Movitz v. First National Bank, 1998 U.S. App. LEXIS 13379 (7th Cir. June 23, 1998). This Court has long recognized the principle that legal consequences require proximate causation in addition to "but for" causation. *See Lanasa Fruit Steamship & Importing Co. v. Universal Ins. Co.*, 302 U.S. 556 (1938).[23]

Even the Bank recognizes that the "but for" causation test is inapplicable and that proximate cause is the proper test. The Bank does so by conceding,

> . . . that the argument that pre-petition equity holders enjoy their post-petition interest 'on account of' their prior interest loses much of its force when an open auction is held and pre-petition equity holders prevail over all other bidders . . .

(Pet. Br. at 11, n.6.) That concession is fatal. Such an auction does not remove prior ownership as a link in the chain of "but for" causation, since equity holders' status as pre-petition owners is what would entitle them, as "parties in interest," to receive notice of the auction at

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[23] *See*, Prosser and Keeton, *The Law of Torts*, § 41 at p. 264 (5th Ed. 1984) ("As a practical matter, legal responsibility must be limited to those causes which are so closely connected with the result and of such significance that the law is justified in imposing liability.") The dissent below asserts that the majority reads Section 1129(b)(2)(B)(ii) as if the word "solely" appeared in front of "on account of," but the majority's interpretation of that phrase follows directly from this Court's construction of the same phrase in *O'Gilvie*.

which they might become the winner.[24] Like Senate confirmation of a Presidential appointee to this Court, an auction would be only one of a series of causes. But, the Bank suggests that the auction is the only cause (i.e., the most direct cause) to which the bankruptcy court should attach legal consequences.[25]

Of course, if proximate cause is the proper test, the proximate cause of an event is a question of fact. As the Ninth Circuit stated in *Bonner Mall*,

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[24] Section 1109 defines, "party in interest," to include equity interest holders. Bankruptcy Rule 2002(d)(6) entitles them to notice of a plan confirmation hearing.

[25] In the same footnote, the Bank itself acknowledges that there is no authority in the Code for the bankruptcy court to hold such an auction. The Bank goes on to argue that, because no auction was held or proposed in this case, the question is not before the Court. The Bank does not explain what an auction could have accomplished in this case, where no one other than old equity holders facing the tax consequences of foreclosure would have been a prospective bidder under the terms of the Plan proposed in this case. Use of an auction in this case to determine the adequacy of the new value paid would have been as effective as a horse race would be to determine which horse is the fastest in a one-horse town. Moreover, the Court in *BFP v. Resolution Trust Corp.* 511 U.S. 531, 537-538 (1994) observed that the price obtained at a public auction sale or a sale forced by the necessities of the owner is the "antithesis" of market value. The National Bankruptcy Review Commission considered and rejected the equity auction concept proposed by the Bank. Instead, the Commission advocates automatic termination of a debtor's exclusive right to file a plan when the debtor proposes a new value cramdown plan. *National Bankruptcy Review Commission Final Report* at 562-564 (October 20, 1997). *See also, In re Moonraker Associates, Ltd.*, 200 B.R. 950, 955 (Bankr. N.D. Ga. 1996) (discussing the myriad of problems posed by an equity auction).

> . . . whether a particular plan gives old equity a property interest 'on account of' its old ownership interests in violation of the absolute priority rule or for another, permissible reason is a *factual question*.

2 F.3d at 911 (emphasis added).

> In this case, the Bankruptcy Court recognized:
> The question is whether this retention of ownership of the debtor is 'on account' of the interests that the partners had at the outset of the case, or whether the retention of ownership is on account of the new capital contributions that the plan requires partners to make.

(Pet. App at 136a.) The Bankruptcy Court then held: "[t]he contribution is easily the equivalent of the interests retained by the debtor's partners." (Pet. App. at 139a.) That factual finding cannot be disturbed unless it is "clearly erroneous." Bankruptcy Rule 8013. Moreover, that factual issue is not before the Court.

Consequently, the interests which contributing partners retained under the Plan were "on account of" their contribution of new capital.

B. The only *property* which Investors received or retained *under the Plan* was the equity interest they purchased with $6.125 million of new value.

In order to skirt the obvious conclusion that the only property obtained by equity holders under the plan is that which they purchased with new value, the Bank and its amici have hypothesized a form of "property" which the Seventh Circuit Court of Appeals labeled "highly conceptualistic". In essence, the Bank contends that the "property" which equity holders received under the plan is the "right" to purchase equity in the reorganized

debtor, and that no one else had the opportunity to purchase equity in the reorganized debtor. (Pet. Br. at 20-23.) The Bank's conceptualization, however, is fanciful, because it ignores two crucial realities: First, that equity holders who agreed to contribute new value were locked into their contributions before the plan was confirmed; and second, that all parties, including the Bank, were free to find more generous buyers for equity interests in the reorganized debtor among an unlimited universe of potential investors.

The Bank and its amici reach their conclusion that the Plan violates the absolute priority rule only by ignoring important language in Section 1129(b)(2)(B)(ii) and by cleverly manipulating the question presented to create the illusion that the *Plan* in this case granted old equity an exclusive opportunity to purchase Reorganized LaSalle. The Bank disregards the rule that each word of the statutory provision at issue must be given operative effect. *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990).

> Section 1129(b)(2)(B)(ii) provides:
> the holder of any claim or interest that is junior to the claims of such class *will not* receive or retain *under the plan* on account of such junior claim or interest any property.

(emphasis added) The italicized language must be given meaning. The language is prospective: "*will* not receive or retain under the plan." A plan is not binding on anyone until after it is confirmed by the bankruptcy court. Section 1141. Logically, therefore, no property can possibly be received or retained by old equity holders "under the plan" until *after* confirmation of the plan.

In this case, prior to the confirmation hearing, the purchase money for the equity in Reorganized LaSalle

was deposited in escrow to be returned to the Investors only if the plan was not confirmed. Appellee's Designation of Additional Items to be Included in the Record on Appeal, Item 9. Accordingly, when the Plan became effective, that money, which was deposited by the Investors who had responded to the capital call, was beyond their reach. Thus, the Bank's statement that:

> . . . the plan of reorganization gave the debtor's pre-bankruptcy equity holders the *exclusive* right to retain their ownership interests in the debtor if they contributed new capital . . .

(Pet. Br. at 6. (italics in original).) is factually incorrect. In fact, the new value had already been contributed before the Plan became effective. The sale of Reorganized LaSalle's equity to the Investors occurred simultaneously with the Plan becoming effective. The Investors had no discretion or ability to back out.[26] Thus, in this case, the pre-petition partners did not receive an opportunity to purchase equity "under the plan."

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[26] In *Consolidated Rock Prods. Co. v. DuBois*, pursuant to the confirmed plan of reorganization, warrants for the future purchase of the reorganized company's stock were issued to pre-petition shareholders in exchange for their old equity. The Court stated:

> It should be noted as respects the warrants issued to the old common stockholders that they admittedly have no equity in the enterprise. Accordingly, it should have been shown that there was a necessity of seeking new money from them and that the participation accorded to them was not more than reasonably equivalent to their contribution.

312 U.S. 510, 529 n.27 (1941). Since no consideration was paid in exchange for the future investment opportunity represented by the warrants, the Court properly struck the plan down. But, that is not this case.

The most obvious "property" received or retained by the holders of old equity in this case, and the only property which they received or retained "under the [confirmed] Plan," is the equity which the Investors purchased in exchange for $6.125 million of new value. But, the Bank would have the Court ignore the actual property that Investors did get under the Plan. Instead, the Bank tries to make something out of the supposed exclusive right to purchase an interest in Reorganized LaSalle.

As a diversionary tactic, the Bank argues:

> Backers of a new value exception shift the focus from the property interest at issue – the exclusive opportunity to obtain an equity stake in the reorganized debtor – to the ownership interest ultimately purchased as a result of exercising that property right. But when the interpretive focus is *not* on the purchased equity interest, but instead, as the statute requires, is on the property interest provided by the plan (the *exclusive right* to share in ownership of the debtor), the conclusion is inescapable that the pre-bankruptcy equity holders are receiving property 'on account of' their pre-bankruptcy interests.

(Pet. Br. at 19-20.)[27]

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[27] The Bank (Pet. Br. at 20) misrepresents *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-209 (1988) as a "square *holding*" that the opportunity to participate in the reorganization is itself property. *Ahlers* had nothing to do with the opportunity to participate in a reorganization. That case held that retention of even a worthless equity interest, under a plan, is "property," under Section 1129(b)(2)(B)(ii). An accurate statement of the Court's holding is: " . . . we think that the interest respondents would retain *under any reorganization* must be considered 'property' under § 1129(b)(2)(B)(ii) and therefore

There is a fatal problem with the Bank's argument. The so called "exclusive opportunity to obtain an equity stake in the reorganized debtor" never existed in this case. It is pure fiction, resourcefully invented by opponents of new value plans to avoid the impact of more than eighty-five years of precedent supporting the exchange of interests in reorganized entities for necessary new value. That the so-called "exclusive opportunity" did not exist is demonstrated by reviewing the process leading toward confirmation of a plan of reorganization by a bankruptcy court.

Section 1121 is entitled: "Who may file a plan." That section provides, in essence, that only the debtor may file a plan for the first 120 days of the case and that the bankruptcy court may reduce or increase that exclusive period "for cause" at the request of a party in interest.[28] To be sure, Congress understood and intended that the "exclusive period" provided by Section 1121 would give some leverage to a debtor in the plan bargaining process.[29] Accordingly, the Bank and its amici, representing only the interests of secured creditors, lobbied heavily

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can only be retained *pursuant to a plan. . . . " Ahlers*, 485 U.S. at 209 (emphasis added).

[28] In this case the Respondent partnership entity, and not its pre-petition partners, was the debtor, with the exclusive right to file a plan. Therefore, the pre-petition partners never had any right, exclusive or otherwise, to file a plan. Before confirmation, the Bank filed a motion in the bankruptcy court seeking to terminate the Debtor's exclusive right to file a plan and sought leave to file its own plan. That motion was denied and the Bank did not appeal.

[29] H.R.Rep. No. 595, 95th Cong., 2nd Sess. (1978) p6191.

against debtor exclusivity when Congress was considering the Code.[30] Not content with the progress they have made in Congress toward amending the Code, they seek to have the Court legislate a significant limitation on a debtor's right under Section 1121.

A debtor's exclusive right to file a plan is nothing more than the right to make the first offer to creditors and interest holders for a proposed restructuring of the debtor entity. No legal rights are created by the offer itself. The mere pendency of an unaccepted offer cannot create "property," i.e., the "opportunity to obtain an equity stake" that the Bank and its allies condemn. If no class of creditors accepts the offer, the offer dies on the vine. Even after the offer of the debtor's proposed plan is accepted by an impaired class of creditors, neither old equity nor any other party in interest has yet received "property."[31] If, and only if, the plan is accepted by at least one class of creditors and confirmed by the bankruptcy court, does the prospective investor's offer become "property."

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[30] That lobbying continues. In response to the secured creditors' lobby, Congress amended Section 362 in 1994 to provide for reduction of the debtor's exclusive period from 120 to 90 days in a "single asset real estate case" [defined by Section 101(51)(B)]. Section 362(d)(3). Creditor lobbying has also resulted in a proposal by The National Bankruptcy Review Commission to amend the Code to provide that the debtor's exclusive period will terminate automatically if the debtor moves to confirm a non-consensual new value cramdown plan under which unsecured creditors will not be paid in full. *National Bankruptcy Review Commission Final Report* (Oct. 20, 1997), Recommendation 2.4.15 at page 457.

[31] The plan must be submitted to the bankruptcy court for a hearing on confirmation.

A plan is not binding upon anyone until after it is confirmed by an order of the bankruptcy court. Section 1141. No one can possibly receive or retain any "property," "under the plan" or otherwise, until *after* the court confirms the plan. In this case, where *prior to confirmation* the new value contribution was already deposited in escrow, beyond the reach of the Investors, old equity *never* had any enforceable option to purchase Reorganized LaSalle's equity. The "exclusive opportunity to obtain an equity stake," championed by the Bank, is a chimera.

A proposed plan *must* provide adequate means for the plan's implementation, such as an investor to fund the plan. Section 1123(a)(5)(J). Congress placed no limitation on the sources from which a plan proponent could seek new capital.

Chapter 11 clearly contemplates competition between plans seeking creditors' acceptance and court confirmation, not competition between potential investors seeking to invest in the same plan.[32] That is evidenced by Section

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[32] An equity auction plan, as suggested by the Bank is unworkable. Because plans are tailored to the particular needs of the investors who propose to fund them, it is unreasonable to presume that a competing investor would want to be bound to the terms of a competitor's plan. It is also unreasonable to believe that a bankruptcy court would find an equity auction plan feasible under Section 1129(a)(11) without evidence that the auction would successfully raise sufficient funds to consummate the plan and provide working capital to the reorganized entity. Such an auction would have been futile in this case where no one other than existing partners would have any incentive to invest. Finally, an auction is unlikely to reflect market value in those cases in which some bidders, such as the Bank in the instant case, are entitled to receive a portion of the proceeds of the auction. That is true, because other bidders will

1121(d), which permits creditors to request termination of the debtor's exclusive period so that another plan can be proposed, and by Section 1129(c), which requires the court to confirm only one plan among competing plans which have been accepted by creditors.

One who agrees to fund a proposed plan is supplying inducement for competing free riding plans. Creditors can "shop" that plan with the possibility that another more generous plan might be proposed and confirmed. It is ludicrous to suggest that one who has made the opening offer to fund an unconfirmed plan has received property under the confirmed plan. In recognition of the fact that the first offeror does not acquire any property until closing of the contemplated transaction, courts frequently approve a "breakup fee" as compensation for supplying the first offer.[33]

II. The New Value Corollary has been an established part of reorganization practice since 1869.

For the reasons set forth above, the Plan satisfied the plain language of Section 1129(b)(2)(B)(ii). The alternative readings suggested by the Bank and its amici are incorrect. If, however, the Court concludes that the language of Section 1129(b)(2)(B)(ii) has more than one plausible

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be reluctant to bid, knowing that their bids can be surpassed by what is in effect the bid of a shill.

[33] Courts have long-recognized that breakup fees may be required to encourage the making of a first offer, since that offer will be shopped around to attract higher offers. *See, e.g., In re Integrated Resources, Inc.*, 135 B.R. 746, 750 (Bankr. S.D.N.Y.), *aff'd*, 147 B.R. 650 (S.D.N.Y. 1992), *appeal dismissed on jurisdictional grounds*, 3 F.3d 49 (2nd Cir. 1993). Courts often erroneously describe an entity making a first offer as a "stalking horse."

meaning (e.g., because the Bank and its amici disagree about the consequences of the meaning of "on account of,"), then consideration of pre-Code practice and legislative history is appropriate to interpret that language. *Dewsnup v. Timm*, 502 U.S. 410 (1992).

Key to understanding the new value corollary is recognizing that the corollary is simply a restatement of the absolute priority rule itself in positive, rather than negative, terms.[34] The right to sell equity in a reorganized entity to pre-petition owners only for a price which is reasonably equivalent to the value received is the flip side of the prohibition against selling that equity for less

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[34] As stated at 7 *Collier on Bankruptcy* ¶1129.04[4][c][i][B] at 1129-109-111 (15th ed. rev. 1998):

> . . . application of *Case's* dicta [the new value corollary] yields the same result in all cases as does the absolute priority rule to the same facts. For all practical purposes, the two are equivalent.
>
> . . . .
>
> The interplay of these relationships means that any contribution of money or money's worth permits owners to retain ownership so long as creditors receive property equal to the debtor's reorganization value. This result obtains, regardless of whether the inquiry starts with the absolute priority rule or *Case's dicta*.

See also, In re Bonner Mall Partnership, 2 F.3d 899, 906 (9th Cir. 1993) *cert. dismissed*, 513 U.S. 18 (1994).

Just as the principle that a debtor may transfer its property for a fair equivalent value is inherent in the prohibition of Section 548(a)(2) against a debtor transferring property for less than a fair equivalent value, so too the new value corollary is inherent in Section 1129(b)(2)(B)(ii). An explicit statement of the corollary in Section 1129(b) would have been a redundancy and would have increased the statutory complexity which the drafters of that Section expressly sought to avoid.

than that price. Indeed, the corollary was recognized by the Court, even before the Court in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939) chose the "absolute priority" doctrine over its competition, the "relative priority" doctrine. The nature of the new value principle as a corollary of the absolute priority rule is illuminated by viewing the absolute priority rule in historical context.

The absolute priority rule originated from the application of fraudulent transfer law to railroad reorganizations accomplished through the vehicle of federal equity receiverships, long before there was any federal reorganization statute.[35] *In re Snyder*, 967 F.2d 1126, 1128 n. 1 (7th Cir. 1992). Unsecured creditors, who were squeezed out in such reorganizations by alliances between secured bondholders and shareholders, attacked those reorganizations as fraudulent transfers intended to hinder, delay and defraud unsecured creditors. The Court sustained such attacks as early as 1869. In *Chicago Rock Island & Pac. R.R. v. Howard*, 74 U.S.(7 Wall) 392 (1869), the Court held that the sale proceeds of an insolvent railroad's assets in the hands of its shareholders were charged with a trust for the benefit of unpaid unsecured creditors. The Court held that: " . . . any one receiving any portion of the fund by voluntary transfer, or *without consideration*, may be compelled to account. . . . " *Howard*, 74 U.S. at 411 (emphasis added). The corollary to that holding is that if shareholders paid fair consideration to the creditors in exchange for what the shareholders received, no trust would have resulted.

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[35] *See*, B. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 74-90 (1991) for an excellent review of the origins and current status of the absolute priority rule.

In 1913 the Court in *Northern Pac. Ry. v. Boyd*, struck down any arrangement by which subordinate rights of shareholders are secured *at the expense of unpaid unsecured creditors*, but also observed that old equity could participate over the objection of an unsecured creditor by making a "fair offer." 228 U.S. 482, 508 (1913). In other words, in *Boyd* the Court reaffirmed its *Howard* holding that creditors are entitled to priority over shareholders, *and* its corollary that "fair offers" by old equity are not at creditor expense. Subsequently, the Court in *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, made it clear that "fair offers" had to be in "money or money's worth." 271 U.S. 445 (1926).

In 1933 and 1934, Sections 77 and 77B respectively, the first reorganization statutes, were added to the Bankruptcy Act of 1898 (the "Act").[36] As finally amended, those sections required, as a condition for confirmation, that proposed plans be found by the court to be "fair and equitable."[37] That statutory language was carried forward without alteration into Chapter X of the Act and finally to Section 1129(b)(1) of the Code.[38]

There is substantial authority demonstrating that courts and commentators recognized that a plan of reorganization utilizing the new value corollary was "fair and equitable." Much of this authority preceded the Court's decision in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S.

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[36] Act of July 1, 1898, Pub.L. 55-171, 30 Stat. 544 (1898) (repealed 1979). See Amicus Brief of Professor Bruce A. Markell for the history of the term "fair and equitable."

[37] That requirement was applicable, irrespective of creditor consent to a plan.

[38] 11 U.S.C. § 621(2) (1970) (Repealed); *Marine Harbor Properties, Inc. v. Manufacturer's Trust Company*, 317 U.S. 78, 85-87 (1942).

106 (1939). Clearly, therefore, the new value corollary was not "invented" by dicta in *Case*. Rather, *Case* properly discussed the new value corollary as black-letter law. In addition to the holding of the Court in *Kansas City Terminal* (a holding on which the Court explicitly relied in *Case*, when the Court later specified the components of the new value corollary), the new value principle was applied to approve reorganizations in several reported pre-Code decisions: *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 28 F.2d 177 (8th Cir. 1928) (after remand from the Supreme Court); *Jameson v. Guaranty Trust Co. of New York*, 20 F.2d 808 (7th Cir. 1927); *Palmer v. Banker's Trust Co.*, 12 F.2d 747 (8th Cir. 1926); *Oehring v. Fox Typewriter Co.*, 272 F. 833 (6th Cir. 1921); *Keech v. Stowe-Fuller Co.*, 205 F. 887 (6th Cir. 1913). *See also*, Swaine, *Reorganization of Corporations; Certain Developments in the Last Decade*, 27 Colum. L. Rev. 901, 914 n. 47 (1927).

Following the Court's decision in *Case*, which specified the components of the new value corollary, the Court applied the new value principle in *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-42 (1946) ("It has long been recognized in reorganization law that those who put new money into the distressed enterprise may be given a participation in the reorganization plan reasonably equivalent to their contribution."), and the principle was recognized in *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 529 n. 27 (1940); *Marine Harbor Properties v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942); and *General Stores Corporation v. Shlensky*, 350 U.S. 462, 466 (1956) ("Readjustment of all or part of debts of an insolvent company without sacrifice by stockholders may violate the fundamental principle of a fair and equitable plan. . . . ").[39]

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[39] The *Mason* case involved a reorganization under Chapter IX of the Bankruptcy Act. The Court confirmed the plan over a

Subsequent to *Case*, numerous pre-Code lower court decisions recognized that the new value principle was part of the absolute priority rule.[40] Furthermore, the leading bankruptcy treatise, 6A *Collier on Bankruptcy*, ¶11.06 at 228-231 (14th ed. 1977), recognized the new value corollary as black-letter law. Until *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 n. 3 (1986), in which the Court, at the urging of the Solicitor General, first questioned the corollary's continued existence under the Code, courts assumed that the new value corollary was alive and well under the Code. *See In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986).

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dissenting unsecured creditor's objection that the party contributing new capital received improper preferential treatment. The Court reaffirmed and applied its ruling in *Case* and held that a party contributing new capital, "may be given a participation in the plan reasonably equivalent to their contribution." *Mason*, 326 U.S. at 541-42. While the contributing party in *Mason* was a creditor rather than an equity holder, the holding in *Mason*, together with the Court's citation to *Case*, clearly demonstrates the Court's understanding of the new value corollary as a principle of general application, regardless of whether an equity holder or a creditor makes the contribution. Indeed, it is clear from the reference in Section 1129(b)(2)(B)(ii) to a "junior claim" that the new value corollary would permit a class of subordinated creditors to cramdown a new value plan on a dissenting class of senior unsecured creditors.

[40] *See, e.g., In re Muskegon Motor Specialties*, 366 F.2d 522 (6th Cir. 1966) (there is no room in new corporation for shareholders of insolvent debtor unless they contribute fresh capital); *See also, In re American Trailer Rentals Company*, 325 F.2d 47 (10th Cir. 1963); *Spitzer v. Stichman*, 278 F.2d 402 (2d Cir. 1960); *In re Universal Lubricating Sys.*, 71 F. Supp. 775 (W.D. Pa. 1947).

In the amicus brief which the Solicitor General, Robert H. Jackson, filed jointly with the Securities and Exchange Commission ("SEC") in *Case*, the Solicitor General brought to the Court's attention:

> the *recognized corollary* of the absolute priority doctrine – the rule that junior interests for whom no equity remains may nevertheless be allowed to participate if they are willing to contribute necessary money or money's worth to the reorganized company.

Brief at 14-15 (emphasis added).[41]

In *Case*, the Court specifically adopted the Solicitor General's position on the elements of the new value corollary, and on the relationship of that corollary to the absolute priority rule. Markell, *supra* note 35 at 91.[42]

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[41] The Bank contends that, " . . . the 'corollary' terminology can be seen as historically inaccurate." Pet. Br. n. 1 at 4. But, Solicitor General Jackson used that term in the brief he filed in 1939. Apparently, the first time the term "exception" was used, was in *Ahlers*.

The SEC also recognized the existence and validity of the new value principle, and its character as part and parcel of the absolute priority rule, in its comprehensive report on protective and reorganization committees. *Securities and Exchange Comm'n. Rep. on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, pt. 8 at 143 (1940). The SEC cited with approval numerous cases recognizing that the absolute priority rule permitted pre-petition owners to retain an interest in reorganized companies in exchange for paying fair value in cash or property. *Id.* at 144-147.

[42] The absence of a reported case under Chapter X involving application of the new value corollary, reinforces the conclusion that the corollary is "black-letter law." The existence of well-settled legal principles rarely result in reported decisions. Furthermore, small non-public companies, which

Considering the fact that it was Solicitor General Jackson's brief which induced the Court to state its *Case dicta*, it is disappointing to see Jackson's representation to the Court that there was a "recognized corollary to the absolute priority doctrine" dismissed by the current Solicitor General with the unsupported statement: "Our subsequent research has shown that suggestion not to be a correct reflection of the law at that time." (SG Br. at 24, n. 25.)[43] With all due respect, it appears that the Solicitor General's office committed itself to a position in *Ahlers*, and is now simply unwilling to reconsider that position, even though it is unable to cite any evidence justifying its abandonment of Solicitor General Jackson's position.

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would be the likeliest candidates for new value plans, being ineligible to file under Chapter X, sought relief under Chapter XI. The fair and equitable requirement was eliminated from Chapter XI in 1952, thereby eliminating any possibility of the new value corollary becoming an issue in those cases. Pub. L. No. 82-456 § 35, 66 Stat. 420, 433 (1952). Furthermore, Chapter X's provision mandating the appointment of trustees caused many larger companies that would have qualified under Chapter X to seek relief under Chapter XI. Markell, *supra* note 35 at 92; 7 *Collier on Bankruptcy* ¶1129.04[4][c] at 1129-106-107 (15th ed. rev. 1998).

[43] In the same footnote, the Solicitor General further attempts to sidestep Jackson's brief on the ground that whatever may have been the law in 1939, in subsequent filings he has consistently taken the position he takes in this case. However, he does *not* point out that during the 59 years which elapsed between *Case* and *Ahlers*, the Solicitor General made no filings on this issue.

III. When Congress enacted the Code, it understood that the New Value Corollary was an established part of reorganization practice and of the absolute priority rule.

Congress was well aware of the *Case dicta* as it considered the legislation that became the Code. That is beyond debate, because Congress considered and rejected a proposal by the Bankruptcy Commission to modify the *Case dicta* by removing its requirement that the new contribution be in cash. Congress explicitly rejected proposals in Section 7-303(4) of the 1973 Bankruptcy Review Commission's Bill (H.R. 31, 94th Cong.) and Section 7-301(4) of the Judges' Bill (H.R. 32 94th Cong.) to expand the new value principle by recognizing the non-monetary contributions prohibited by *Case*. In commenting on those proposals, counsel to the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee wrote:

> The 'future contribution' doctrine sharply departs from the absolute priority rule of § 221(2) of the Bankruptcy Act. The Supreme Court decision in *Case v. Los Angeles Lumber Products Co.*, 306 U.S. 106 (1939) is overruled. The proposal follows the district court opinion in that case.

See Bankruptcy Act Revision, Hearings before the Subcommittee on Constitutional and Civil Rights of the House Committee on the Judiciary on H.R. 31 and 32, 94th Cong., 1st and 2d Sess., Ser. 27, App. 248 (1976). This commentary makes it abundantly clear that Congress understood the new value principle to be part of (i.e. a

corollary of) the absolute priority rule codified in the "fair and equitable" requirement of Chapter X, and intended to make no change to that "black-letter" principle when it carried the "fair and equitable" requirement forward into the Chapter 11 of the Code.[44]

The Court also understood that the *Case dicta* was part of the absolute priority rule when it observed:

> When considering adoption of the current Code, Congress received a proposal by the Bankruptcy Commission to modify the *absolute priority rule* to permit equity-holders to participate in a reorganized enterprise based on their contribution of 'continued management . . . essential to the business' or other participation beyond 'money or money's worth.'

Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 205 (1988) (emphasis added).

IV. Variances between the Bankruptcy Act and the Code have no effect on the meaning of "fair and equitable."

To be sure, Congress reformed the Bankruptcy Act of 1898 and made changes in reorganization law when it enacted the Code. Many of those changes were designed

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[44] All of the commentary and discussion on the new value principle cited by the Solicitor General (SG Br. 18-21) reflects criticism of provisions, such as those contained in H.R. 31 and H.R. 32, which either: a) expanded the new value principle to include non-cash contributions, or b) permitted participation by equity holders five years after confirmation if such participation was justified by the financial condition of the reorganized enterprise at that time. This legislative history reinforces the conclusion that Congress intended no change to the new value corollary and carried the new value corollary forward, without alteration, into the Code as part of the requirement that a plan be "fair and equitable."

to remove the delay and inflexibility which caused financially troubled companies to shun Chapter X and, instead, seek relief under Ch XI. 7 *Collier on Bankruptcy*, ¶1129.04[4][c][1][A] at 1129-106 (15th ed. rev. 1998) However, the Code made no change whatsoever in the *substance* of the rule that a court must confirm a reorganization plan over the dissent of unpaid unsecured creditors when the plan is "fair and equitable" with respect to those creditors. Nor did Congress make any change in the "fixed principle" of *Boyd* when it codified that principle, together with the new value corollary, in Section 1129(b)(2)(B)(ii).

The Bank and its amici attempt to make much of the unremarkable point that Congress relaxed the absolute priority rule by allowing the majority within an impaired creditor class to waive the absolute priority rule. (Pet. Br. at 27 n. 15.) This argument, however, simply misses the point. By requiring a dissenting *class, rather than an individual creditor* to invoke the absolute priority rule, the Code merely changed the identity of the party who possessed standing to invoke the absolute priority rule. This change in standing had no effect on the substance of either the absolute priority rule or its new value corollary. Regardless of whether a single creditor, as under Chapter X, or a class, as under Chapter 11, invokes that rule by voting to reject a plan, *the standard for confirming a plan over the dissenting vote, that a plan be "fair and equitable," is the same under the Code as it was under the Act.*[45] Thus, even

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[45] Thus, whether the plan in *Case* would have been confirmed under Chapter 11 is not relevant. (Pet. Br. at 37.) The absolute priority rule focuses on those who dissent, not on those who accept a plan. The *standard* which the Court applies in determining whether to confirm a plan over a dissent is the same under Section 1129(b) as it was in *Kansas City Terminal* and *Case*.

if circumstantial evidence of Congressional intent were sufficient to alter the well recognized meaning which the phrase "fair and equitable" acquired before 1978, no evidence of such intent has been submitted to this Court.[46]

V. The New Value Corollary is consistent with Bankruptcy Code policies.

A. The new value plan in this case maximized value for *all* creditors.

The purpose of Chapter 11 reorganization is to maximize value for creditors. *Toibb v. Radloff*, 501 U.S. 157, 163 (1991). The Plan in this case successfully met the objectives of Chapter 11.[47] *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) ("Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.' "); *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997) (recognizing that going concern value may exceed liquidation value). The going-concern premium in this case was the

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[46] This case is materially different from *Union Bank v. Wolas*, 502 U.S. 151 (1991), where the Court found that Congress had made a *substantive change* in preference law by eliminating the substantive requirement of proof that the defendant had reasonable cause to believe that the debtor was insolvent when it made an alleged preferential transfer. See also: *United Savings v. Timbers of Inwood Forest*, 484 U.S. 365, 380 (1988) ("Such a major change in the existing rules [Code] would not likely have been made without specific provision in the text . . . it is most improbable that it would have been made without even any mention in the legislative history.").

[47] The bankruptcy court recognized that the Plan fulfilled the objectives of Chapter 11 when it made a factual finding that the plan proponents acted in good faith in filing the Plan. That finding was affirmed on appeal. Pet. App. 143a-145a; 28a-29a.

Investors' $6.125 million of new capital. In addition, by waiving their right to distributions on account of an aggregate of $7.7 million of allowed unsecured claims held by them, the Debtor's general partner and an affiliate effectively injected an additional $3 million of working capital into Reorganized LaSalle. (Pet. App. at 128a-130a, 139a n. 5.) That premium would not have been available in a foreclosure or Chapter 7 case. The reorganization enabled unsecured trade creditors who had originally bargained for recourse against the Debtor, as contrasted with the Bank who did not, to be paid in full. That proposed treatment induced those trade creditors to accept the Plan.

The Bank also shared in and benefitted from the premium. As a result of having contractually agreed at the time it made its loan to the Debtor to look only to the real estate, and to waive recourse against any other property of the Debtor, the Bank would have had no unsecured claim outside of Chapter 11. But, Section 1111(b), an innovation of the Code, provides that nonrecourse secured creditors, such as the Bank, who are undersecured, must be treated in Chapter 11 as if they had recourse.[48] In addition to giving the Bank the full

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[48] That provision, along with the new Code Section 1111(b)(2), which permits undersecured creditors to elect not to have their claim bifurcated as required by Section 506(a), but to treat the entire claim as a secured claim, was designed to protect a lender against undervaluation of its collateral in connection with a cramdown. "Prior to adoption of the Bankruptcy Code, there were many Chapter XII cases [under the Act] which dramatized the valuation risk associated with the cramdown power." 7 *Collier on Bankruptcy* ¶1111.03[1][a][iii][A] at 1111-20 (15th Ed. rev. 1998). It is ironic that the Bank, which complains about valuation, never availed itself of the protection which Section 1111(b)(2) was expressly designed to provide.

present value of its secured claim, the Plan provides the Bank's unsecured deficiency claim with a distribution on account of that claim of at least $19 million, which at the time of confirmation of the Plan, had a minimum present value in excess of $6 million. The Plan's minimum $19 million distribution to the Bank on account of its artificially created deficiency claim represents a huge windfall.[49] The facts belie the Bank's contention that it was "short changed." (Pet. Br. at 8.)

If, as advocated by the Bank, an undersecured creditor can block a plan of reorganization which has been accepted by other creditors, because the plan is to be funded by pre-petition equity holders, an undersecured creditor will have greater rights than an oversecured creditor. This will incentivize marginally secured creditors to undervalue their collateral and thus take control of a reorganization.

We are compelled to reply to the hyperbolic prediction of the Bank's amici, the American College of Real Estate Lawyers, that the decision below, "not only threatens existing mortgage debt held by lenders, but also threatens the future of the real estate and real estate securities industry." (ACREL Br. at 23-24.) Although *In re*

Therefore, it is disingenuous for the Bank to state that it was "*left* with an unsecured deficiency claim of $38.5 million," when it elected to be treated as an unsecured creditor. (Pet. Br. at 5-6 (emphasis added).)

[49] Had it made the Section 1111(b)(2) election, the Bank would have had only a $93 million secured claim, and no artificially created unsecured deficiency. To further its goal of foreclosing, the Bank chose not to make the Section 1111(b)(2) election. Absent that deficiency claim, the Bank would have lacked standing, as an unsecured creditor, to object that the Plan violated Section 1129(b)(2)(B)(ii).

Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993) has been on the books for some time, the real estate industry has had the greatest boom since the Depression.

B. The New Value Corollary does not improperly deprive creditors of "control".

The task of determining who has control of a Chapter 11 case begins where all such inquiries must begin: with the language of the statute itself. Even a cursory examination of the Code reveals the misleading nature of the catch-phrases used by the Bank to describe the supposed evil – loss of creditor control – resulting from the new value corollary. (Pet. Br. at 41.) The Code prescribes which, if any, of the parties in interest in a Chapter 11 case has control of each step of the reorganization process.[50] The Code also spells out the role of the bankruptcy court under Chapter 11.

The Bank's policy arguments against the new value corollary ignore the mandate of Section 1129(b)(1). Those arguments read out of the Code a bankruptcy judge's statutory obligation to confirm a plan over the rejection of a dissenting unsecured creditor class which the bankruptcy court finds to have been treated "fairly and equitably".[51] Reduced to their true essence, the Bank's policy

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[50] *United Savings v. Timbers of Inwood Forest*, 484 U.S. 365, 378 (1988) ("The debtor in process of reorganization . . . is given many temporary protections against the normal operation of the law.").

[51] For at least eighty-five years, this Court has recognized that a creditor who has received a fair offer is estopped from contesting its treatment under a plan which allows for participation by a debtor's equity holders. *Northern Pac. Ry. v. Boyd*, 228 U.S. 482 (1913); *Kansas City Terminal Ry. v. Central*

arguments against the new value corollary would have this Court rule that: (1) an *undersecured* creditor, and not the bankruptcy judge, should become the arbiter of disagreements between classes, and (2) such a creditor has an *absolute right* to veto any plan which is not to its liking, even if the plan satisfies the legal standard which this Court prescribed in the *Kansas City Terminal* case and repeatedly reaffirmed. The Bank urges this Court to disregard the plain language of Section 1129(b), and to overrule that long-standing precedent, because of the Bank's desire for total control of the reorganization process. Although the Bank has standing in this Court solely on the basis of its artificially created *unsecured* deficiency claim, the Bank complains that: "The new value plan here prevents the bank from foreclosing. . . . "[52] (Pet. Br. at 42.) The Bank suggests no principled basis (other than its desire to foreclose and wipe out other creditors) why its vote against the Plan should take precedence over the trade creditors' vote in favor of the Plan.[53]

The Bank suggests that the new value corollary promotes "judicial second-guessing" of creditors' business judgement which is "contrary to fundamental bankruptcy

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Union Trust Co., 271 U.S. 445 (1926). The Solicitor General would, instead, give a dissenting class of creditors the right to veto a plan which treated it "fairly and equitably" within the meaning of those cases.

[52] The Bank had no right to foreclose because the Property was necessary to an effective reorganization that was in prospect. *United Savings v. Timbers of Inwood Forest*, 484 U.S. 365, 375-376 (1988).

[53] One can only speculate what position the Bank would take in cases where the numbers were reversed, and a class of recourse unsecured creditors holding large claims opposed a plan which the Bank, holding a small undersecured deficiency claim, supported.

policy." (Pet. Br. at 48, n. 27.) In support of this patently incorrect statement, the Bank quotes a portion of this Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988), but distorts the meaning of that statement by omitting the crucial words which are italicized in the following complete quotation:

> the Code provides that it is up to the creditors – and not the courts – to accept or reject a reorganization plan *which fails to provide them adequate protection or fails to honor the absolute priority rule.*

By its misquotation, the Bank represents that this Court has held that Section 1129(b) does not require bankruptcy judges to override the vote of a dissenting class which has received fair and equitable treatment. The Court did no such thing. The Court was not questioning, or even addressing, the bankruptcy court's statutory mandate in Section 1129(b)(1), to "second-guess" the decision of a dissenting class regarding a plan.

The facts of *In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986), illustrate the harmful effect of a ruling in the Bank's favor. In that case, a single class consisting of one unsecured creditor, a Teamsters Committee which had a claim for damages growing out of rejection of a burdensome collective bargaining agreement, voted to reject a plan of reorganization which had been accepted by other unsecured creditors. Apparently, the Teamsters voted to reject the plan, not because the plan was unfavorable to its interests as a creditor, but because the Teamsters had a non-creditor interest in blocking rejection of collective bargaining agreements. The plan was funded by a $100,000 of new value by the Investors. The Bank's interpretation of 1129(b) would have deprived all other creditors of the benefits of the plan and allowed the Teamsters to defeat the plan, in order to establish a precedent in

negotiations with other trucking companies. Section 1129(b) should not be read to permit such a result, simply because former shareholders have facilitated a reorganization by paying fair value for the equity of the reorganized entity.

Another example of possible mischief from sustaining the Bank's position, would be a case in which a church found itself in financial difficulty, perhaps as a result of an environmental problem. Suppose that the church building had been pledged to secure a non-recourse loan for an amount far in excess of the value of that collateral. Suppose that a generous plan which paid unsecured creditors much more than they could ever get on account of their claims from a liquidation and which also provided for remediation of the environmental problem was to be funded by a substantial contribution of fresh cash from the church members. Suppose further, that the plan was accepted by the overwhelming majority of creditors, but that the holder of the relatively small separately classified non-recourse deficiency claim, relying upon the fact that he could hold the collateral hostage for the full amount of his claim, voted against the plan, even though it provided that creditor with far more cash than he would ever receive from any other source.[54] Rejecting the new value corollary would prevent confirmation of such a plan, and enable the non-recourse undersecured creditor either to blackmail other creditors into allowing him to be paid in full or to cause a liquidation in which the undersecured creditor would foreclose on the church building, unsecured creditors with recourse

[54] As set forth above, the Seventh Circuit requires that non-recourse unsecured deficiency claims be placed in a separate class. *In re Woodbrook Associates*, 19 F.3d 312, 319 (7th Cir. 1994).

would lose their reorganization premium and the church members would be wiped out. Even the Bank would have difficulty characterizing such a scenario as proper "creditor control."[55]

C. Judicial fallibility is no reason to ignore the plain language of the Code.

Much of the Bank's dissatisfaction with the new value corollary is based not on the substance of the rule, but rather, on purely hypothetical fears that bankruptcy judges will err in valuing debtor firms, and thereby permit old owners to purchase a reorganized entity's equity too cheaply. (Pet. Br. at 45.)[56]

[55] Section 1129(b)(2)(b)(ii) applies in all Chapter 11 cases, the overwhelming majority of which involve small privately held companies, whose access to capital markets is restricted. Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 Yale L.J. 437, 441 (1992).

Common sense dictates that equity holders of such entities are an important, if not the only source of reorganization capital for such debtors. Since Section 1129(b)(2)(B)(ii) also applies to Chapter 9 of the Code, which deals with the adjustment of debts of a municipality, pursuant to Section 901 of the Code, one can postulate similar fact situations where members of a water district or other "municipality," as defined in Section 101(40), would be blocked by a recalcitrant class of creditors from confirming a plan of reorganization which otherwise treated its creditors fairly and equitably, because the old members were funding the plan with a substantial contribution of fresh cash.

[56] The Bank does not argue that the contributing partners *in this case* paid too little for their interests in Reorganized LaSalle. No such argument is possible; the bankruptcy court made a factual finding that the contributing partners paid a fair price for their equity in Reorganized LaSalle. (Pet. App. at 139a.) That finding was upheld on appeal and has not been challenged here. (Pet. App. at 24a-26a.)

The Bank's argument proves too much. Independent of the Corollary, a bankruptcy judge who applies the absolute priority rule must value a debtor's business. *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 524 (1940). Indeed, there are a myriad of issues arising under the Code which can be resolved only by bankruptcy judge's valuation decision. *See, e.g.*, Sections 362(d)(2)(A), 506(a), 548(a)(2)(A) and 1129(b)(2)(B)(i). If the existence of legal rules depended on the infallibility of judges, no such rules would survive. Carrying the Bank's argument to its logical conclusion leads to the patently absurd result that bankruptcy judges, and indeed *all judges*, should be prohibited from ever making valuation decisions.[57] But the Bankruptcy Code cannot be administered in the absence of valuation decisions. If the Bank thinks bankruptcy judges are suddenly unfit to value property after doing so for more than one hundred years, the Bank should seek redress from Congress, not the Court.[58]

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[57] In *Associates Commercial Corporation v. Rash*, 520 U.S. 953 (1997), the Court resolved a dispute about the standard to be used by bankruptcy courts for valuing a security interest when the debtor invokes the cram down power to retain the collateral over a secured creditor's objection. The Bank's argument would render that case a nullity.

[58] A variation on the theme that bankruptcy judges are incompetent, is the Bank's suggestion that new value plans always involve allegedly improper self-dealing by insiders. This argument assumes that bankruptcy courts will invariably fail to properly assess whether old equity holders are paying a fair price for their new equity in the reorganized entity. This Court expressed no such concerns in its *Boyd, Kansas City Terminal, Case* or *DuBois* decisions.

Furthermore, the Bank is simply wrong when it states (Pet. Br. at 43) that Section 363 prohibits a debtor from selling property to its shareholders. The Code contains no such prohibition. *In re W.A. Mallory Co., Inc.*, 214 B.R. 834, 838 (Bankr. E.D. Va. 1997), the only case which the Bank cites for an assertion which is at odds with the plain language of Section 363(b), merely holds that sales to insiders are subject to a higher level of scrutiny than sales to non-insiders. *Id.* at 837. In fact, nothing in the plain language of Section 363 of the Code prohibits a debtor's transactions with insiders. The new value corollary subjects sales to equity holders to a higher level of scrutiny than funding offers from other investors by requiring contributing equity holders to pay a fair price. Notably, a plan which proposed to sell a reorganized entity's equity to a total stranger can be confirmed without any finding that the stranger paid a fair price, so long as the plan satisfies Section 1129(a)(7)(A)(ii).

The Bank suggests that valuation problems did not arise under Chapter X due to the existence of disinterested trustees. (Pet. Br. at 44.) However, the Bank does not explain why Chapter X trustees, the Securities and Exchange Commission and bankruptcy courts were any less fallible than are today's bankruptcy judges in valuing businesses, as they were required to do when applying the absolute priority rule. *DuBois*, 312 U.S. at 570.

VI. Conclusion

For all of the reasons set forth above, Respondent respectfully requests that the Court affirm the Court of Appeals.

Respectfully submitted,

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Supreme Court, U.S.
FILED
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No. 97-1418

In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

JOINT APPENDIX

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TABLE OF CONTENTS

Page

Relevant Docket Entries Not Included iii

Relevant Docket Entries in the United States Court of Appeals for the Seventh Circuit in Docket Nos. 96-2137 and 96-2138 (Consolidated) 1

Relevant Docket Entries in the United States Court of Appeals for the Seventh Circuit in Docket No. 95-3891 (on Petition for Writ of Mandamus) 5

Relevant Docket Entries in the United States District Court for the Northern District of Illinois, Eastern Division 7

Relevant Docket Entries in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division 11

Bankruptcy Court's Denial of Motion of Bank of America Illinois to Terminate Debtor's Exclusive Right to File and Solicit Acceptances of a Plan of Reorganization (April 17, 1995) 16

Order Confirming Plan (December 5, 1995) (Plan attached as Exhibit A thereto) 18

Page

Transcript of Proceedings in the Bankruptcy Court (December 5, 1995) (Excerpts) 77

Transcript of Proceedings in the District Court (December 6, 1995) (Excerpts) 90

Reorganized Debtor's Supplemental Status Report on Plan of Reorganization (December 27, 1995) 104

Bankruptcy Court's Final Decree (December 28, 1995) 112

Affidavit of Marc R. Wilkow (February 1, 1996) 113

RELEVANT DOCKET ENTRIES NOT INCLUDED

The following opinions, decisions, judgments, and orders have been omitted in printing this joint appendix because they appear at the pages indicated in the appendix to the Petition for a Writ of Certiorari:

Memorandum of Decision of the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division, dated December 5, 1995 . . . . . 102a

Memorandum Opinion and Order of the United States District Court for the Northern District of Illinois, Eastern Division, dated April 30, 1996 . . . . . 50a

Judgment of the United States District Court for the Northern District of Illinois, Eastern Division, dated April 30, 1996 . . . . . 101a

Decision of the United States Court of Appeals for the Seventh Circuit, dated September 29, 1997 . . . . . 1a

Order of the United States Court of Appeals for the Seventh Circuit on petition for rehearing and suggestion for rehearing en banc, entered November 25, 1997 . . . . . 48a

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 96-2137 & 96-2138	)	
	)	Appeal from the
IN THE MATTER OF:	)	United States
	)	District Court for
203 N. LaSALLE STREET	)	the Northern
PARTNERSHIP,	)	District of
an Illinois Limited Partnership,	)	Illinois, Eastern
	)	Division.
Debtor-Appellee,	)	
	)	Nos. 95 C 7144
APPEAL OF:	)	& 96 C 238
	)	
BANK OF AMERICA ILLINOIS,	)	Paul E. Plunkett,
	)	Judge.
Appellant.	)	

RELEVANT DOCKET ENTRIES

5/8/96	Bankruptcy case docketed.
5/8/96	Filed Appellant Bank of America IL docketing statement.
5/14/96	ORDER: The court orders these appeals CONSOLIDATED for purposes of briefing and disposition.
5/29/96	Filed motion by Appellee 203 N. LaSalle in 96-2137, Appellee 203 N. LaSalle in 96-2138 to dismiss case as imprudent.

6/12/96	Filed Appellant Bank of America IL in 96-2137, Appellant Bank of America IL in 96-2138 response to Appellee 203 N. LaSalle in 96-2137, Appellee 203 N. LaSalle in 96-2138 motion to dismiss case.
6/18/96	IT IS ORDERED that the following motion(s) and/or document(s) shall be taken with the case for determination by the merits panel: "MOTION TO DISMISS APPEAL AS IMPRUDENT" filed 5/29/96 and "APPELLANT'S RESPONSE TO MOTION TO DISMISS APPEAL AS IMPRUDENT" filed 6/12/96. The clerk will distribute these items and a copy of this order to the panel. The parties are directed to address the issues raised by the motion in their merits briefs.
7/1/96	Filed motion by Appellee 203 N. LaSalle in 96-2137, Appellee 203 N. LaSalle in 96-2138 for reconsideration of the court's 6/18/96 order.
7/12/96	ORDER issued DENYING motion to reconsider.
7/15/96	Filed 15c appellant's brief by Bank of America IL in 96-2137, Bank of America IL in 96-2138.
7/15/96	Filed 10c appendix by Appellant Bank of America IL in 96-2137, Appellant Bank of America IL in 96-2138.
8/15/96	Filed 15c appellee's brief by 203 N. LaSalle in nos. 96-2137 and 96-2138.

8/29/96	Filed 15c appellant's reply brief by Bank of America IL in 96-2137 and 96-2138.
11/6/96	Case heard and taken under advisement by panel: Circuit Judge Walter J. Cummings, Circuit Judge Kenneth F. Ripple, Circuit Judge Michael S. Kanne.
9/29/97	Filed opinion of the court by Judge Ripple. AFFIRMED. Circuit Judge Walter J. Cummings, Circuit Judge Kenneth F. Ripple, Circuit Judge Michael S. Kanne, dissenting.
9/29/97	ORDER: Final judgment filed per opinion.
10/10/97	Filed 30c Petition for Rehearing with Suggestion for Rehearing Enbanc by Appellant Bank of America IL in 96-2137 and 96-2138.
10/22/97	Filed motion by Appellant Bank of America IL in 96-2137, Appellant Bank of America IL in 96-2138 to correct inadvertent omission from Petition for Rehearing.
10/24/97	ORDER issued GRANTING motion to correct in 96-2137, 96-2138. The clerk of this court is directed to file instanter the tendered copies of the Petition for Rehearing with Suggestion for Rehearing en Banc.
10/24/97	Filed 30c Petition for Rehearing with Suggestion for Rehearing Enbanc by Appellant Bank of America IL in 96-2137, Appellant Bank of America IL in 96-2138, per order. Dist.

10/29/97	Filed 30c Answer of Appellee 203 N. LaSalle in 96-2137, Appellee 203 N. LaSalle in 96-2138 to Petition for Rehearing with Suggestion for Rehearing Enbanc. Dist.
11/25/97	ORDER: Appellant Bank of America IL in 96-2137 and 96-2138 Petition for Rehearing with Suggestion for Rehearing Enbanc is DENIED. NOTE: Circuit Judge Joel M. Flaum did not participate in the consideration of the petition for rehearing en banc. Circuit Judges Coffey, Easterbrook, Manion, Kanne, and Diane P. Wood voted to grant rehearing en banc.
12/3/97	MANDATE ISSUED AND ENTIRE RECORD RETURNED WITH BILL OF COSTS IN THE AMOUNT OF $120.60.
3/5/98	Filed notice from the Supreme Court of the filing of a Petition for Writ of Certiorari. Supreme Court Case No.: 97-1418.
5/7/98	Filed order from the Supreme Court GRANTING the Petition for Writ of Certiorari. Supreme Court Case No.: 97-1418.

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

IN THE MATTER OF:	)	Application for Writ of
	)	Mandamus from the
BANK OF AMERICA ILLINOIS,	)	United States District
Petitioner	)	Court for the Northern
	)	District of Illinois,
No. 95-3891	)	Eastern Division.
	)	
	)	No. 95 C 7144
	)	
	)	Hon. Paul E. Plunkett,
	)	Judge.

RELEVANT DOCKET ENTRIES

12/7/95	Original and 3 copies of Application for Writ of Mandamus [re: stay of bankruptcy court orders pending appeal] filed.
12/8/95	ORDER: Filed clerk's notice to counsel for the respondent to file a response to "EMERGENCY REQUEST FOR ISSUANCE OF WRIT OF MANDAMUS" filed 12/7/95. The request for an emergency stay is DENIED.
12/13/95	Filed Party-in-Interest 203 N. LaSalle objection (on behalf of the respondent) to Petitioner Bank of America IL Emergency Petition for Writ of Mandamus.

12/14/95	Filed motion by Petitioner Bank of America IL to file reply to Objection to Emergency Petition for Writ of Mandamus.
12/15/95	ORDER issued GRANTING motion to file reply and the clerk of this court is directed to file instanter the tendered copies of the Reply to Debtor's Objection to Bank of America Illinois' Emergency Petition for Writ of Mandamus.
12/15/95	Filed Petitioner Bank of America IL reply to Party-in-Interest 203 N. LaSalle Objection to Bank of America Illinois' Emergency Petition for Writ of Mandamus, per order.
12/22/95	ORDER filed re: #1. "EMERGENCY REQUEST FOR ISSUANCE OF WRIT OF MANDAMUS," filed on 12/7/95, IT IS ORDERED that #1 is DENIED.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

BANK OF AMERICA, ILLINOIS,	)	Consolidated Cases
	)	Nos. 95 C 7144 &
Appellant,	)	96 C 0238
	)	
v.	)	Appeal From
	)	No. 95 B 4998
203 NORTH LASALLE STREET	)	Chapter 11
PARTNERSHIP, an Illinois	)	
limited partnership,	)	
	)	Hon. Paul E. Plunkett
Appellee.	)	

RELEVANT DOCKET ENTRIES

12/6/95	2	EMERGENCY MOTION by appellant for stay pending appeal; Notice of emergency motion. [Entry date 12/19/95]
12/6/95	3	AFFIDAVIT of Thomas S. Kiriakos in support of motion for stay pending appeal [2-1]. [Entry date 12/19/95]
12/6/95	4	MINUTE ORDER of 12/6/95 by Hon. Paul E. Plunkett: Oral argument on Bk of Amer IL's motion for stay pending appeal held. Ruling on motion set for 12/07/95. [Entry date 12/19/95]
12/6/95	5	OBJECTIONS by appellee to Bk of Amer IL's motion for stay pending appeal. [Entry date 12/19/95]

12/7/95	6	MEMORANDUM, OPINION, AND ORDER. [Entry date 12/19/95] [Edit date 12/19/95]
12/7/95	7	MINUTE ORDER of 12/7/95 by Hon. Paul E. Plunkett: Enter memorandum opinion and order: the motion for Bk of Amer IL for a stay of the bankruptcy court's confirmation order pending appeal [2-1] is denied. [Entry date 12/19/95] [Edit date 12/19/95]
1/3/96	10	CERTIFIED copy of Order from the 7th Circuit [re: Petition for a Writ of Mandamus re stay pending appeal]. [Entry date 01/05/96]
1/3/96	11	MOTION by appellee 203 N LaSalle St to dismiss appeal; Notice of motion. [Entry date 01/05/96]
2/5/96	19	MEMORANDUM by appellee in support of motion to dismiss appeal [11-1] as moot (Exhibits). [Entry date 02/06/96] [Edit date 02/06/96]
2/7/96	22	BRIEF of appellant (Attachments). [Entry date 02/09/96]
2/27/96	23	TRANSCRIPT of proceedings for the following date(s): 12/06/95, 01/03/96 Before Honorable Paul E. Plunkett. [Entry date 02/28/96] [Edit date 02/28/96]
3/5/96	24	MEMORANDUM by appellant in opposition to motion to dismiss appeal as moot. (Exhibit) [Entry date 03/06/96]

3/5/96	25	APPELLANT's Brief by appellant. [Entry date 03/06/96]
3/5/96	26	APPENDIX filed by appellant regarding brief. [Entry date 03/06/96]
4/5/96	29	REPLY brief of appellant Bk of Amer IL (Attachments). [Entry date 04/08/96]
4/5/96	30	REPLY MEMORANDUM by 203 N LaSalle St in support of motion to dismiss appeal as moot. [Entry date 04/08/96]
4/30/96	31	MEMORANDUM OPINION AND ORDER [Entry date 05/01/96]
4/30/96	32	MINUTE ORDER of 4/30/96 by Hon. Paul E. Plunkett: Status hearing held. Enter memorandum opinion: The Debtor's motion to dismiss the bank's appeal as moot is denied. The Bankruptcy Court's order confirming the debtor's second amended plan of reorganization, dated 09/11/95, as modified is affirmed and the Bankruptcy Court's orders denying the bank's motion for relief from the automatic stay and denying the bank's motion for conversion are affirmed. Terminating case. Mailed notice. [Entry date 05/01/96]
4/30/96	33	ENTERED JUDGMENT [Entry date 05/01/96]

5/7/96	34	NOTICE OF APPEAL by Bk of Amer IL to the United States Court of Appeals for the Seventh Circuit from motion minute order entered 04/30/96 with jurisdictional statement. [Entry date 05/08/96]
5/7/96	34	JURISDICTIONAL STATEMENT by appellant regarding appeal with notice of appeal. [Entry date 05/08/96]
5/10/96	36	MINUTE ORDER of 5/10/96 by Hon. Paul E. Plunkett: Pursuant to Fed.R.Civ.P. 60(a), the Court sua sponte corrects the memorandum opinion and order of 04/30/96 as follows: In section VII, second paragraph, on page 35, the second sentence: "Furthermore, the insider trade debt is paid in full under the Plan," is corrected to read: "Furthermore, the non-insider trade debt is paid in full under the Plan".
11/28/97	40	COPY of Order dated 11/25/97 from the 7th Circuit. It is ordered that the petition for rehearing and suggestion for rehearing en banc be, and the same is hereby denied.
12/4/97	43	CERTIFIED COPY of order from the 7th Circuit: Affirming the decision of the District Court.
12/4/97	44	OPINION from the 7th Circuit: Argued 11/06/96; Decided 09/29/97. (96-2137 and 96-2138)

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
	)	
203 North LaSalle Street	)	
Limited Partnership,	)	Bankruptcy Case
	)	No. 95 B 4998
Debtor.	)	

RELEVANT DOCKET ENTRIES

03/13/95	1	VOLUNTARY petition under chapter 11 [EOD 03/14/95]
04/13/95	36A	MOTION to Terminate Debtor's Exclusive Right to File and Solicit Acceptances of A Plan of Reorganization by Bank of America Illinois
04/17/95	37	ORDER DENIED per Minute Order Re: Item #36A. [EOD 04/18/95]
06/02/95	92A	MOTION In Regards to Automatic Stay (Relief) by Bank of America Illinois [EOD 06/09/95]
05/18/95	94A	MOTION to convert from chapter 11 to chapter 7 by Bank of America Illinois [EOD 06/09/95]

05/18/95	94B	MOTION to Dismiss by Bank of America Illinois [EOD 06/09/95]
09/11/95	132A	PLAN of Reorganization by Debtor
09/13/95	135A	DISCLOSURE Statement dated 9/11/95 [EOD 09/14/95]
10/11/95	153A	OBJECTION of Bank of America Illinois to Confirmation of Debtor's Plan of Reorganization Dated 9/11/95 [EOD 10/12/95]
10/18/95	157A	PLAN of Reorganization (First Amended) dated 9/11/95 [EOD 10/19/95]
10/26/95	163A	PLAN of Reorganization dated 9/11/95 (Second Amended) [EOD 10/27/95]
12/04/95	176	PLAN of Reorganization (Debtor's 2nd Amended dated 9/11/95) [EOD 12/05/95]
11/30/95	178A	MOTION for Stay pending appeal by Bank of America Illinois [Disposed] [EOD 12/05/95]
12/04/95	176	PLAN of Reorganization (Debtor's 2nd Amended dated 9/11/95) [EOD 12/05/95]
12/05/95	180	ORDER Confirming Plan Re: Item # 163A. [EOD 12/06/95]

12/05/95	181	MEMORANDUM Opinion and Order - for the reasons set forth, the court finds that the debtor has established that its 9/11/95 plan complies with all of the applicable requirements of sections 1129 except for section 1129(a)(7) [EOD 12/06/95]
12/05/95	182	ORDER Approving Disclosure Statement dated 9/11/95 nunc pro tunc 9/12/95 [EOD 12/06/95]
12/05/95	184	ORDER DENIED (per minute order) Re: Item # 178A. [EOD 12/06/95]
12/05/95	185	ORDER DENIED (per minute order) Re: Item # 92A. [EOD 12/06/95]
12/05/95	185A	ORDER DENIED (per minute order) Re: Item # 94A. [EOD 12/06/95]
12/05/95	185B	ORDER DENIED (per minute order) Re: Item # 94B. [EOD 12/06/95]
12/06/95	187	NOTICE of Appeal by Bank of America Illinois Re: Item # 180. [EOD 12/06/95]
12/05/95	189A	MOTION for Stay of Order Pending Appeal by Bank of America Illinois [Disposed] [EOD 12/07/95]
12/06/95	190	ORDER DENIED (per minute order) Re: Item # 189A. [EOD 12/07/95]

12/06/95	192	TRANSMITTED Expedited Appeal to USDC - Assigned to Judge Plunkett; Magistrate Judge Ashman, 95C 7144 Re: Item # 187. [EOD 12/07/95]
12/18/95	198A	NOTICE of Appeal by Bank of America Illinois in re items #185, 185A and 185B [Disposed] [EOD 12/20/95]
12/18/95	198C	STATEMENT of Issues Re: Item # 198A. [EOD 12/20/95]
12/27/95	200B	SUPPLEMENTAL Status Report of Plan of Reorganization by Debtor [EOD 12/28/95]
12/28/95	204	FINAL Decree - case is closed; provided, however, that the case will be reinstated if the matter if reversed on appeal Re: Item # 203A. [EOD 12/29/95]
12/28/95	207B	STATEMENT of Issues [EOD 01/02/96]
01/10/96	209	ORDER CLOSING CASE [EOD 01/10/96]

05/03/96	211	CERTIFIED Copy of Order From the U.S. District Court Dated: April 30, 1996 of USDC Judge Plunkett - Enter Memorandum Opinion and Order: The Debtor's motion to dismiss the Bank's appeal as moot is denied; The bankruptcy court's order confirming the debtor's Second Amended Plan of Reorganization dated September 11, 1995 as modified is affirmed; and the bankruptcy court's orders denying the Bank's motion for relief from the automatic stay and denying the Bank's motion for conversion are affirmed. Re: Item # 198A. [EOD 05/03/96]

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Name of Presiding Judge, Honorable Eugene R. Wedoff

Cause No. 95 B 4998 Date April 17, 1995

Title of Cause: In Re: 203 North LaSalle Street Partnership, an Illinois limited partnership

Brief Statement of Motion: Motion of Bank of America Illinois to Terminate Debtor's Exclusive Right to File and Solicit Acceptances of a Plan of Reorganization

The rules of this court require counsel to furnish the names of all parties entitled to notice of the entry of an order and the names and addresses of their attorneys. Please do this immediately below (separate lists may be appended).

Names and Addresses of moving counsel: Thomas S. Kiriakos, Richard G. Ziegler, Craig E. Reimer
Mayer, Brown & Platt, 190 South LaSalle Street, Chicago, Illinois

Representing: Bank of America Illinois

Names and Addresses of other counsel entitled to notice and names of parties they represent. See attached Service List

Reserve space below for notations by the Courtroom Deputy

For the reasons stated in open court, motion of Bank of America Illinois to terminate debtor's exclusive right to file and solicit acceptances of a plan of reorganization is denied.

Hand this memorandum to the Courtroom Deputy.
Counsel will not rise to address the Court until motion has been called.

/s/ Eugene R. Wedoff

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
	)	
203 North LaSalle Street	)	
Limited Partnership,	)	Bankruptcy Case
	)	No. 95 B 4998
Debtor.	)	

[December 5, 1995]

ORDER CONFIRMING PLAN

Debtor's Plan of Reorganization Dated September 11, 1995 filed by 203 North LaSalle Street Partnership on October 26, 1995, having been transmitted to creditors and interest holders; the Debtor having twice amended the said plan in a manner which did not require re-solicitation of creditors; Bank of America Illinois having objected to confirmation of the Plan, as amended; the Court having conducted an evidentiary hearing on the said plan, as amended; the parties having filed post-trial memoranda; the Court having considered all of the above and, following the Debtor's modification in the treatment of Class 4 creditors as reflected in the Debtor's Second Amended Plan Of Reorganization Dated September 11, 1995, As Modified, (the "Plan"), having overruled Bank of America Illinois' objections to confirmation; and

The Court having determined after hearing on notice that the requirements for confirmation set forth in 11 U.S.C. § 1129(a) and (b) have been satisfied;

IT IS HEREBY ORDERED that:

1. The Plan, a copy of which is attached hereto, is hereby confirmed.

2. American National Bank & Trust Company of Chicago ("American National") as trustee under that certain Trust Agreement dated July 20, 1983 and known as Trust No. 58252 ("Trust Agreement" or "Trust") , is hereby authorized and directed to execute and deliver that certain First Amendment To Lease dated November 14, 1995 by and between Rudnick & Wolfe, a general partnership, and American National, solely as trustee under the Trust Agreement, notwithstanding the absence of consent thereto by Bank of America Illinois as holder of a first collateral assignment of the beneficial interest in the Trust.

3. This Order shall become effective immediately upon its entry on the docket sheet which the bankruptcy court clerk maintains in this case.

/s/ Eugene R. Wedoff
U.S. Bankruptcy Judge

ENTERED Dec. 5, 1995

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

(Title omitted in printing)

Honorable Eugene Wedoff

DEBTOR'S SECOND AMENDED
PLAN OF REORGANIZATION
DATED SEPTEMBER 11, 1995, AS MODIFIED

203 North LaSalle Street Partnership, an Illinois limited partnership ("Debtor"), proposes the following Second Amended Plan of Reorganization Dated September 11, 1995, As Modified:

1. DEFINITIONS

The definitions and rules of construction set forth in the Bankruptcy Code and Federal Rules of Bankruptcy Procedure shall apply when the words and phrases defined and construed therein are used in this Plan. The following terms, when used in this Plan, shall, unless the context otherwise requires, supplement the foregoing definitions and rules of construction and have the following meanings, respectively:

1.1 Allowed Amount: The amount in which a Claim is allowed pursuant to § 502 of the Code, by Final Order or pursuant to the terms of the Plan.

1.2 Assignment of Beneficial Interest: That certain Security Assignment of Beneficial Interest in Land Trust, dated June 25, 1987 and executed by Land Trust Beneficiary in favor of the Bank, and any modifications and amendments thereto.

1.3 Bank: Bank of America Illinois, as successor in interest to Continental Illinois National Bank and Trust Company of Chicago.

1.4 Bank's Deficiency Claim: The unsecured portion of the Bank's Claim, which shall be an amount equal to the Bank's Claim as shown on Schedule D of the Schedules, and any amendments thereto, filed in the Case, minus (a) $1,149,000; (b) the original principal amount of the Interest-Bearing Note; and (c) all sums paid by the Debtor to the Bank between the Petition Date and the Effective Date; plus (x) the Allowed Amount of any administrative claims and the Allowed Amount of any claims under Section 506(c) of the Code, it and to the extent such administrative claims and Section 506(c) claims are paid from rents on which the Bank has or claims a lien.

1.5 Case: The above-captioned reorganization case for Debtor.

1.6	Code:	United States Bankruptcy Code, 11 U.S.C. §§ 101 et. seq.
1.7	Confirmation Order:	The order of the Court which confirms the Plan.
1.8	Court:	The United States Bankruptcy Court for the Northern District, Eastern Division of Illinois, presiding in the Case, or any other court exercising jurisdiction over the Case.
1.9	Debtor:	203 North LaSalle Street Partnership, an Illinois limited partnership.
1.10	Economic Value:	"Economic Value" shall mean the value of the Property, as if sold to a bona fide third party in an arms length transaction, in its "as is" condition, as though unencumbered by the Mortgage or any other liens. Such Economic Value shall be determined by an appraisal of the Property by three independent appraisers who shall be members of the Appraisal Institute and certified as "M.A.I." appraisers and who shall have at least five (5) years experience in appraising properties similar to the Property and which are located in the same metropolitan area as the Property. One such appraiser shall be appointed by Bank and one appointed by Reorganized Debtor, not later than ten (10) days after

the written request of Reorganized Debtor as provided below. The third appraiser shall be selected by the appointed appraisers. If either Bank or Reorganized Debtor shall fail to timely appoint an appraiser, the appointed appraiser shall select the second appraiser not later than ten (10) days after Bank's or Reorganized Debtor's failure to appoint such second appraiser. If the two appraisers so appointed shall be unable to agree on the selection of a third appraiser within ten (10) days after the two initial appraisers have been appointed, then either appraiser, on behalf of both appointed appraisers, may request the appointment of the third appraiser by the Court. No appraiser shall have any personal or financial interest which would prevent such appraiser from exercising an independent and impartial judgment as to the value of the Property. The "Economic Value" of the Property shall be equal to the arithmetic average of the valuation of the Property as determined by each of such appraisers in accordance with the provisions hereof; provided, however, that if any valuation deviates by more than ten percent (10%) from the average of all such valuations, then the "Economic Value" of the Property shall be equal to the arithmetic average of the two valuations closest to such average. The appraisers shall submit a written

appraisal report to Reorganized Debtor and Bank within thirty (30) days after the appointment of such appraisers. The Reorganized Debtor and Bank shall each pay fifty percent (50%) of the cost of such appraisals. The Economic Value of the Property shall be determined in accordance with the procedures set forth above upon the written request of Reorganized Debtor made at any time within seventy-five (75) days prior to a refinancing of the indebtedness evidenced by the Interest Bearing Note, but in no event later than forty-five (45) days prior to such refinancing.

1.11 Effective Date: The first business day after the Confirmation Order is entered on the docket sheet maintained for the Case.

1.12 Excess Cash Flow: Gross operating income plus proceeds of any litigation and capital contributions from partners minus (a) operating expenses, including, without limitation, real estate taxes, (b) debt service interest expense and scheduled amortization with respect to the Interest-Bearing Note and (c) monies to fund a capital reserve account, which shall not exceed ten cents per square foot of rentable area, if the Bank gives the Reorganized Debtor written notice that the Reorganized

Debtor should establish a capital reserve account.

1.13 Final Order: An order which is no longer appealable to any court.

1.14 Interest-Bearing Note: A note in the principal amount of $53,395,000 to be executed by the Land Trust. Base interest shall be calculated by applying to the unpaid principal amount of the note outstanding from time to time a fixed base interest rate equal to 350 basis points over a United States Treasury obligation with comparable duration (assuming no extension of the maturity date as provided herein) determined as of the Effective Date, which base interest shall be payable monthly in arrears beginning on the first business banking day of the first full calendar month following the Effective Date. In addition, the note shall provide for the payment of Participation Interest. The principal amount of the note shall be amortized based on a thirty year amortization schedule, and the unpaid principal amount of the note shall be due and payable upon the first to occur of (a) a sale or refinancing of the Property; (b) the seventh anniversary of the Effective Date unless on or before 5:00 p.m. central standard time on the seventh

anniversary of the Effective Date (or on the first business banking day thereafter if the seventh anniversary falls on a weekend or a holiday) the Reorganized Debtor gives the Bank written notice of the Reorganized Debtor's election to extend the maturity date of said note for an additional three years ("Extension Period") and by simultaneously paying to the Bank a fee in the amount one-half of one percent of the then outstanding principal amount of said note, and provided that said outstanding principal amount is not greater than 75% of the Economic Value of the Property determined as of the 180th day before the seventh anniversary of the Effective Date. Anything herein to the contrary notwithstanding, during the Extension Period the unpaid principal balance of the said note shall bear interest at a fixed base rate equal to 350 basis points over a United States Treasury obligation with a comparable duration, i.e., three years determined as of the seventh anniversary day of the Effective Date (or on the first business banking day thereafter if the seventh anniversary falls on a weekend or a holiday). The Reorganized Debtor shall make partial pre-payments (without penalty) of the principal amount of the note by making monthly payments of Excess Cash Flow, if any, to the Bank beginning on the tenth business day of the second full calendar month beginning

after the Effective Date and continuing on the tenth business day of each calendar month thereafter until the said note has been paid in full. The foregoing sentence to the contrary notwithstanding, the Reorganized Debtor may, from time to time, submit to the Bank written requests for the Bank to advance to the Reorganized Debtor the amounts requested to pay the cost of the following: (a) alterations, including, without limitations, capital improvements; (b) tenant improvements; and (c) leasing commissions provided, however, the Reorganized Debtor may not request advances exceeding the total amount of Excess Cash Flow previously paid to the Bank (less the amount of any prior advances). In connection with any such request, the Reorganized Debtor shall cooperate with an engineer designated by the Bank. The Bank shall have sole discretion regarding any such request. The Bank shall be deemed to have consented to any such request by the Reorganized Debtor for such an advance unless the Bank delivers to the Reorganized Debtor a written objection to such an advance within ten (10) business banking days after the Bank's receipt of a request for an advance. Any such objection shall set forth in detail the grounds for such objection. The amount of said advances shall be added to the then outstanding principal balance of the

said note. The note may not be prepaid in full before the second anniversary of the Effective Date, except to the extent that any prepayment is from the proceeds of a condemnation award or the proceeds of insurance. Thereafter, the note may be prepaid in full without penalty.

Except as otherwise provided below, neither the Land Trust nor the Debtor nor any of the general partners of the Debtor (collectively, Debtor and said partners are referred to herein as the "Obligated Parties") shall under any circumstances be personally liable for the repayment of any of the principal or interest (including base interest and Participation Interest) on, or prepayment fees or late charges, or other charges or fees, including, without limitation, attorneys' fees, due in connection with the Interest-Bearing Note or any other amounts due thereunder or for any deficiency judgment which the Bank may obtain after foreclosure of the Mortgage after default by Land Trust (all such sums hereinafter collectively called the "Loan Debt"); provided, however, that the Obligated Parties shall be, jointly and severally, personally responsible for any liability, loss, or damage (including, without limitation, reasonable attorneys' fees and disbursements in the event that the Bank shall prevail in any action to enforce such liability, loss or damage,

but excluding the principal of and the interest accrued on the Interest-Bearing Note) (i) arising out of any fraud or material misrepresentation relating to facts and circumstances arising after the Effective Date with respect to the Property, misapplication of insurance proceeds, condemnation awards, security deposits or trust funds in violation of applicable law or the provisions of the Mortgage, (ii) arising out of the failure to comply with the provisions of the Mortgage prohibiting the sale or further encumbering of the Property (iii) arising out of willful attempts to interfere with the Bank's rights under the assignment of rents, (iv) arising out of the failure of the Land Trust or Debtor to perform its obligation, if any, under the Interest-Bearing Note and the Mortgage to preserve, protect and maintain the Property and to apply the proceeds of rents and other income of the collateral toward the costs of maintenance and operation of the Property, and debt service and other indebtedness, such liability being limited to gross revenues of the Property received by the Land Trust or the Debtor (exclusive of funds held in any lockbox controlled by the Bank), (v) arising out of waste or the willful destruction or willful damage to the Property, or to the electrical, plumbing, heating or air conditioning systems or elevators of the Property,

such liability being limited to the gross revenues of the Property received by the Debtor, (vi) arising out of the Debtor's receipt of rentals for periods of more than one (1) month in advance under leases of the Property (exclusive of funds held in any lockbox controlled by the Bank), (vii) arising out of the receipt by Debtor of monies in connection with the modification of any existing or future lease or the entering into of a new lease in violation of the applicable provisions of the Mortgage (exclusive of funds held in any lockbox controlled by the Bank), or (viii) resulting from any claim, demand, determination, judgment, verdict or holding that the relationship of the Debtor and the Bank is that of joint venturers, partners, tenants in common, joint tenants or any relationship other than that of debtor and creditor to the extent such claim, demand, determination, judgment, verdict or holding arises out of a claim, assertion or litigation directly or indirectly brought by or on behalf of the Debtor and/or its partners; and provided, further, that the foregoing limitations on personal liability with respect to the Interest-Bearing Note shall not impair the validity of the indebtedness secured by the Bank's collateral or the lien on or security interest in the collateral or the right of the Bank as mortgagee or secured party to foreclose and/or enforce the mortgage

lien or security interest or other interest in the collateral or any part thereof after default.

1.15 Land Trust: American National Bank and Trust Company of Chicago, not individually, but as trustee under trust agreement dated June 20, 1983 and known as Trust No. 58252.

1.16 Land Trust Beneficiary: Debtor.

1.17 Loan Agreement: That certain Loan Agreement dated as of June 25, 1987, between Land Trust, Land Trust Beneficiary, and the Bank, and any modifications and amendments thereto.

1.18 Mortgage: That certain Construction Mortgage, Assignment of Leases and Rents, Security Agreement and Fixture Filing upon the Property dated June 25, 1987 and recorded July 1, 1987 in the Office of the Recorder of Deeds of Cook County, Illinois as Document No. 87360282, and any modifications and amendments thereto.

1.19 Net Economic Value: Economic Value less (a) any unpaid principal of the Interest-Bearing Note together with interest thereon accrued and unpaid through the date of closing (b) all closing costs including, without

limitation, professional fees, surveying costs, brokerage fees and commissions, title charges, mortgage taxes, and loan fees and charges.

1.20 Net Proceeds: Net Sale Proceeds, or Net Refinancing Proceeds, as the case may be, remaining after payment of Participation Interest.

1.21 Net Refinancing Proceeds: With respect to a refinancing of the then-outstanding indebtedness on the Property reflected in the Interest-Bearing Note, the actual amount of proceeds which the Reorganized Debtor is entitled to receive in connection therewith, net, to the extent actually paid, of (a) any unpaid principal of the Interest-Bearing Note, together with interest thereon accrued and unpaid through the date of closing, and (b) all closing costs including, without limitation, professional fees, surveying costs, brokerage fees and commissions, title charges, mortgage taxes, and loan fees and charges.

1.22 Net Sale Proceeds: With respect to a sale of the Property, the sale proceeds which the seller is entitled to receive after deducting from the gross sale price, to the extent actually paid, (a) all costs of sale, including, without limitation, brokerage commissions, professional fees, title

charges, survey costs, transfer taxes, operating expenses and all real estate tax prorations, and (b) any unpaid principal of the Interest-Bearing Note, together with interest thereon accrued and unpaid through the date of closing.

1.23 Participation Interest:

(a) In the event of a sale of the Property, an amount equal to fifty percent (50%) of the Net Sale Proceeds.

(b) In the event of a refinancing of the then-outstanding indebtedness on the Property reflected in the Interest-Bearing Note, fifty percent (50%) of the Net Economic Value of the Property.

1.24 Petition Date: March 13, 1995

1.25 Plan: This Plan of Reorganization.

1.26 Priority Claims: All Claims entitled to priority under Section 507(a) of the Code.

1.27 Promissory Note: That certain Promissory Note dated June 25, 1987 made by Land Trust in favor of the Bank in the original principal sum of $85,000,000 and any modifications and amendments thereto.

1.28 Property: The air rights and improvements thereon commonly known as 203 N. LaSalle Street, Chicago, Illinois, and legally described on Exhibit A attached hereto.

1.29 Reorganized Debtor: Debtor after the Effective Date.

1.30 Transportation Center Owner: American National Bank and Trust Company of Chicago, not personally but solely as Trustee under Trust Agreement dated June 18, 1981 and known as Trust No. 52947.

2. CLAIMS AND INTERESTS

The Claims and interests in the Plan are divided into the following classes:

Class 1: Priority Claims.

Class 2: Secured Tax Claims.

Class 3: Secured Claim of the Bank.

Class 4: All unsecured Claims, other than those in Classes 1, 5, and 6.

Class 5: The Bank's Deficiency Claim.

Class 6: Claim of North LaSalle Street Limited Partnership secured by its pre-petition second mortgage on the Property.

Class 7: The interests of the Debtor's general and limited partners.

3. TREATMENT OF UNIMPAIRED CLASSES

3.1 Class 1: Except to the extent that a holder of a Claim in Class 1 has agreed to a different treatment of its Claim, the Allowed Amount of each Claim in Class 1 shall be paid to the holder thereof on the Effective Date or as soon as practicable thereafter.

3.2 Class 2: The Class 2 Claim is unimpaired and unaltered under the Plan and shall be paid in full, together with statutory penalties within 30 days following the Effective Date. The source of payment shall be (a) with respect to the principal portion of the said Claim, funds from LaSalle National Bank Account #236363-7 in the name of M & J Wilkow, Ltd., and (b) with respect to statutory penalties which accrued after the Petition Date, funds deposited in the debtor-in-possession's Tax Account pursuant to cash collateral orders entered during the Case for payment of said penalties.

4. TREATMENT OF IMPAIRED CLASSES

The following Claims and interests are impaired under the Plan:

4.1 Class 3:

(a) The Allowed Amount of the Class 3 Claim shall be fully settled and satisfied by delivery to the Bank, within 5 business banking days after the Effective Date, of (i) the sum of $1,149,500 to reduce the Bank's secured claim to the principal amount of the Interest-Bearing Note (ii) the Interest-Bearing Note, (iii) a commitment fee of $266,975 or such greater amount, not to exceed $545,000, as the Court may determine, which the Bank need not apply to reduce the Bank's secured claim and thereafter by Reorganized Debtor's payment of the

obligations evidenced in said Note in accordance with the terms of said Note and the Plan.

(b) The Interest-Bearing Note shall be secured by the liens and security interests created by (i) the Mortgage, (ii) the Assignment of Beneficial Interest, (iii) appropriate UCC financing statements (iv) the notes evidencing the Deferred Payments referred to below in Section 5.2 of the Plan which notes shall be delivered to the Bank, for collateral purposes only, within 5 business banking days after the Effective Date, (v) the accounts to be established at the Bank pursuant to Section 5.10 of the Plan, and (vi) all personal property of the Reorganized Debtor in which the Bank held valid and perfected security interests as of the Petition Date. Such instruments, documents, financing statements, and the Loan Agreement shall be deemed modified to the extent required to conform to the terms hereof. In the event of any inconsistency between the terms of (a) either the Plan or the Interest-Bearing Note and (b) either the Loan Agreement, the Mortgage, or any other instrument, document, or financing statement, the terms of the Plan and the Interest-Bearing Note shall govern. Confirmation of the Plan shall be deemed to cure any default by the Debtor under the terms of the Loan Agreement, the Mortgage, or any document related thereto, that may have existed prior to the Effective Date of the Plan.

(c) The foregoing treatment of the Bank's Class 3 Claim is without prejudice to any rights the Debtor, the Reorganized Debtor, or any of their respective general and limited partners may have against the Bank.

4.2 Class 4: The Allowed Amount of the Class 4 Claims shall be fully settled and satisfied as follows:

(a) on the Effective Date the Reorganized Debtor shall pay each such holder, other than North LaSalle Street Limited Partnership and Tamanda II Corporation, the Allowed Amount of such holder's claim in full without interest. If and only if the Plan is confirmed, North LaSalle Street Limited Partnership and Tamanda II Corporation waive their Class 4 claims as of the Effective Date.

(b) The provisions of this Section 4.2 shall not be deemed to affect Class 4 creditors' rights to seek payment of their claims from the Debtor's general partners under state partnership law.

4.3 Class 5: The Bank's Deficiency Claim shall be fully settled and satisfied by payment to the holder of the Class 5 Claim of Net Proceeds, if any, until the said Claim has been paid in full without interest.

4.4 Class 6: The Claim of North LaSalle Street Limited Partnership secured by the its pre-petition second mortgage on the Property shall be fully settled and satisfied by payment in full to the holder thereof in accordance with the terms of Section 5.7 below.

4.5 Class 7:

(a) The interests of the general partners and limited partners of the Debtor shall be fully settled and satisfied as follows:

(b) Said partners shall make, or cause to be made, the capital contributions to the Reorganized Debtor described below in Section 5.2, and shall be treated in accordance with the provisions of said Section 5.2 of the Plan if one or more such partners fail to make the required capital contributions to the Reorganized Debtor;

(c) The capital contributions made by the Reorganized Debtor's Partners shall be treated in accordance with the terms of Section 5.7 below;

(d) Ownership percentages in the Reorganized Debtor are hereby modified and, after the Effective Date, shall equal the percentage of the capital contribution made by or on behalf of each partner pursuant to Section 4.5(b) and 5.2 of the Plan;

(e) As of the Effective Date, CTC G.P., Inc., one of the Debtor's two general partners, will be deemed to have resigned as the Reorganized Debtor's general partner and CTC G.P., Inc.'s interest in the Reorganized Debtor shall be converted to a limited partnership interest;

(f) The Debtor's partnership agreement, as amended, shall be deemed modified as of the Effective Date so as to reflect said proportionate partnership interests, to provide that North LaSalle Street Limited Partnership is the Reorganized Debtor's sole general partner and to be otherwise consistent with the terms hereof.

5. MEANS FOR EXECUTION OF THE PLAN

5.1 On the Effective Date, all property of the estate shall be vested in the Reorganized Debtor free and clear of all liens, Claims and encumbrances except those liens, Claims and encumbrances provided for herein.

5.2 The general partners and limited partners of the Reorganized Debtor shall contribute or cause to be contributed $6.125 million of new capital (the "New Capital") to the Reorganized Debtor as follows: $3.0 million in cash ("Initial Capital") on the first business banking day after the Effective

Date, and $625,000 on each of the next five anniversaries of the Effective Date ("Deferred Payments"). As security for the Deferred Payments, within five (5) business banking days following the Effective Date, North LaSalle Street Limited Partnership, the Reorganized Debtor's sole general partner, shall deliver or cause to be delivered, to Bank one or more irrevocable letters of credit (the "Letter of Credit" or, collectively, the "Letters of Credit") in the initial aggregate face amount of $1,250,000, which amount shall be reduced by $625,000 if and when the first four Deferred Payments have been made on a timely basis. Such reduction may be effected by substituting a new Letter of Credit in the appropriate amount. The Letter of Credit shall name Bank as the beneficiary and may be drawn upon if any Deferred Payment is not made when due. As additional security for the payment of $1,875,000 of the Deferred Payments, the general partner of the Reorganized Debtor shall cause to be delivered to Bank, as soon as practicable after the Effective Date, a collateral assignment of eighty percent (80%) of the net fees payable under the agreements referred to below in Sections 7.1(a) and 7.1(b) of the Plan. The general partner and limited partners of the Reorganized Debtor shall determine among themselves the amount of contribution (in the form of cash, Deferred Payments and Letters of Credit) to be made by the general partner and each limited partner. The partnership interest in the Reorganized Debtor or North LaSalle Limited Partnership, as the case may be, of any partner who fails to timely make the foregoing required contribution, or any part thereof, shall automatically be deemed terminated.

5.3(a) Within five (5) business banking days following the Effective Date, the Reorganized Debtor shall establish an escrow account at Near North Title Insurance Company and shall deposit therein a deed to the Property in favor of the Bank or its nominee together with such other documents and

assignments (including, without limitation, a consent judgment of foreclosure) as Bank shall request, within ten (10) business banking days after the Effective Date, in the exercise of its reasonable discretion, in order to convey, transfer and assign to Bank or its nominee all of Reorganized Debtor's right title and interest in and to the Property and such items of personal property located thereon or used in connection therewith as are subject to the Bank's valid and perfected security interests. Reorganized Debtor shall have a reasonable period of time to comply with a request by the Bank for deposit of documents in escrow pursuant to the terms of this Section 5.3(a). Upon payment in full of the Allowed Amount of the Class 3 Claim, the escrow account shall be terminated, and the all documents and instruments deposited therein shall be returned to the Reorganized Debtor.

5.3(b) Marc R. Wilkow ("Wilkow") hereby covenants and agrees that he shall personally pay to Bank the sum of $10 million if and only if he causes the Reorganized Debtor to file a voluntary petition under the Code at any time before the first to occur of payment in full of the Interest-Bearing Note or delivery to Bank of the deed to the Property pursuant to Section 6.1 hereof. Upon payment in full of the Interest-Bearing Note, or upon delivery to Bank of a deed to the property pursuant to Section 6.1, the said covenant and agreement shall terminate and have no force or effect.

5.3(c) M & J Wilkow, Ltd. and M & J Wilkow Brokerage Services Corporation hereby covenant and agree that (i) they shall not assign their respective rights and obligations under the agreements referred to below in sub-sections (a) and (b) of Section 7.1 of the Plan without the Bank's prior written consent, and (ii) the Bank shall have the right, in its sole discretion, to direct M & J Wilkow, Ltd. and M & J Wilkow Brokerage Services Corporation to assign their rights and obligations under said agreements to one or more third parties

to be designated by the Bank, if and only if (x) the Reorganized Debtor files a voluntary petition under Title 11 of the United States Code or (y) an involuntary petition under Title 11 is filed against the Reorganized Debtor by an affiliate of the Reorganized Debtor and said involuntary petition is not dismissed within 60 days after the date on which it is filed.

5.4 After the entry of the Confirmation Order, the Reorganized Debtor shall have the right to object to any Claim and to take all actions necessary to litigate, compromise or settle any objection, provided, however, Court approval of any such compromises or settlements shall not be required.

5.5 If a check issued in payment of all or any portion of any Claim is returned as undeliverable after reasonable efforts to deliver have been made by the Reorganized Debtor, the check payee shall forfeit its rights to that payment. Any such check shall be voided and the funds covered by said check shall remain property of the Reorganized Debtor.

5.6 other than (a) payment of management fees, leasing commissions and construction supervision fees and (b) reimbursement of out-of-pocket expenses, no distributions shall be made to general partners or limited partners of the Reorganized Debtor until the Bank has received the payment prescribed in Section 4.3.

5.7 Following payment in full of the Allowed Amount of the Claims in Classes 1 through 5, the Class 6 Claim and the interests in Class 7 shall receive any remaining Net Proceeds in the following priorities:

(a) Return of Initial Capital;

(b) Return of Deferred Payments with a priority to the party providing the Letter of Credit;

(c) Repayment to M & J Wilkow, Ltd. of any unreimbursed partnership expenses;

(d) 20% annual yield on Initial Capital;

(e) 10% annual yield on Deferred Payments;

(f) 10% annual yield on unreimbursed expenses;

(g) the next $3 million to Initial Capital;

(h) the next $2.5 million to Deferred Payments;

(i) An amount equal to the difference between the "New Capital Benefits" (as defined in the September 8, 1995 Memorandum from Marc R. Wilkow to the Partners of the Debtor) and the sum of any payments made pursuant to the foregoing (except under c and f) to Initial Capital;

(j) Repayment of the Allowed Amount of the Class 6 Claim with interest at 10% per annum;

(k) The balance, if any, pro rata to all parties funding New Capital based on their respective percentage shares.

All annual yields, to the extent not paid currently, are cumulative, but not compounded.

5.8 All funds in LaSalle National Bank Account #236363-7 remaining after payment of the Class 2 Claim shall be paid to Reorganized Debtor within five (5) business banking days after the Effective Date. Such funds shall be used for working capital.

5.9 Upon a sale, or transfer pursuant to Section 6.1 below, of the Property, all funds held in reserve accounts will be distributed to creditors in accordance with the terms of this Plan.

5.10(a) As soon as practicable after the Effective Date, the Reorganized Debtor shall establish at the Bank the Reorganized Debtor's depository account, operating account and a separate real estate tax escrow account, and shall transfer to said accounts any balances which the Debtor, or the Reorganized Debtor, maintained in comparable accounts (estimated to be approximately $800,000 after payment of the Class 2 Claim) at any other financial institutions as of the date of the transfer. The Reorganized Debtor shall maintain such accounts exclusively at the Bank until the Interest-Bearing Note has been paid in full, and all such accounts shall be interest-bearing accounts.

(b) Following the establishment of the real estate tax escrow account referred to above in subsection (a) of this Section 5.10, each month the Reorganized Debtor shall deposit in said account an amount equal to one-twelfth (1/12th) of the real estate taxes which were paid with respect to the Property during the prior calendar year, less the amount of said real estate taxes paid directly by tenants of the Property.

(c) As soon as practicable following the Effective Date, the Reorganized Debtor shall establish a lock-box at the Bank for use by tenants of the Property as a direct depository account for payments due from tenants under the Reorganized Debtor's leases with said tenants, and the Reorganized Debtor shall notify such tenants to make all such payments to the lock-box. The terms of the operation and maintenance of such lock-box shall be established by mutual agreement of the Reorganized Debtor and the Bank or, in the absence of such agreement, by the Court. The Reorganized Debtor shall

maintain such lock-box until the Interest-Bearing Note has been paid in full. Upon request by the Reorganized Debtor, from time to time, the Bank shall transfer funds from the foregoing depository account to the Reorganized Debtor's operating account.

5.11 Following the Effective Date, the Bank shall have the sole discretion to approve leases, including, without limitation, lease amendments between the Reorganized Debtor and third parties. The Reorganized Debtor shall submit copies of such lease documents to the Bank before executing such lease documents, and the Bank shall be deemed to have consented to any such lease document unless the Bank delivers to the Reorganized Debtor a written objection to the terms of said lease document on or before the tenth business banking day after submission of said lease document to the Bank. Any such objection shall state in detail the grounds for such objection.

5.12 If a petition under the Code or similar law or statute is filed by or against the Reorganized Debtor, then Reorganized Debtor hereby irrevocably agrees that (a) it shall not contest, and it shall consent to, the relief requested in any motion or application of the Bank made in any court of competent jurisdiction seeking modification or termination of any automatic stay or other injunction against the Bank resulting from such filing, and (b) the Reorganized Debtor shall execute any order or other document necessary to effectuate such modification or termination.

5.13 Until written notice identifying a different individual is given pursuant to the terms hereof, all notices, objections and documents to be delivered either to the Reorganized Debtor or the Bank pursuant either to any Section of the Plan or to any document executed in connection with the Plan shall be delivered to the following individual:

(a) If to the Reorganized Debtor:

Marc R. Wilkow
M & J Wilkow, Ltd.
180 North Michigan Avenue
Suite 200
Chicago, Illinois 60601

(b) If to the Bank:

Gary Katunas
Bank of America Illinois
231 South LaSalle Street
Chicago, Illinois 60697

5.14(a) The Reorganized Debtor shall furnish to the Bank within forty-five (45) days after the end of each calendar month, beginning with the calendar month in which the Effective Date occurs, balance sheets and statements of profit and loss, and statement of receipts and disbursement of the Property for the prior calendar month. In addition, the Reorganized Debtor shall furnish to the Bank within ninety (90) days after the end of each calendar year of the Reorganized Debtor's operation of the Property, a balance sheet and statement of profit and loss for the Property, reasonably satisfactory to the Bank. All statements (monthly and annual) shall also show comparisons with the annual budget amounts by income and expense categories. Each statement, except as provided in subparagraph (d) hereof, shall be certified as correct by the Reorganized Debtor.

(b) Reorganized Debtor shall also provide the Bank with bank statements, bank reconciliations, copies of bills, waivers, and other documents as reasonably requested by the Bank.

(c) All statements and information supplied shall be prepared in accordance with generally accepted accounting principles consistently applied.

(d) Notwithstanding subparagraph (a) above, the Bank shall have the right to demand that the annual financial statements of the Property's operation be certified by an independent certified public accountant. In addition, the Bank shall at any time have the right to select and appoint an independent certified public accountant to perform financial audits of the books of records on the Property as it deems necessary. Any of the above audits shall be at Reorganized Debtor's expense.

(e) The Reorganized Debtor shall permit the Bank to examine in the office of M & J Wilkow, Ltd., such records, books and papers which reflect upon the financial condition, income and expenses of the Property, and the business conducted thereat.

(f) Within twenty (20) days after request by the Bank, the Reorganized Debtor shall furnish to the Bank a written statement containing the names of all tenants of the Property, the terms of their respective tenancies, the space occupied and the rentals paid therefor. Such statement shall be certified by the Reorganized Debtor.

6. EVENT OF DEFAULT; REMEDIES

6.1 If any monetary default occurs under the Plan with respect to the Interest-Bearing Note, or under any documents, instrument or agreement executed in furtherance thereof, or if the partners fail to make or cause to be made, any contributions of New Capital required by Section 5.2 hereof, and any such default continues following the expiration of any applicable cure period, Bank shall have the immediate right to receive any or all of the documents deposited in the escrow established

pursuant to Section 5.3 of the Plan, and to take all actions with respect thereto necessary or appropriate to take title to, or otherwise dispose of, the Property and the Bank's other collateral.

7. EXECUTORY CONTRACTS AND UNEXPIRED LEASES

7.1 As of the Effective Date, Debtor's (a) Office Space Management Agreement dated November 20, 1991 with M & J Wilkow, Ltd. (f/k/a M & J Wilkow Management Corporation), (b) Amended and Restated Brokerage and Leasing Agreement dated November 20, 1991 with M & J Wilkow Brokerage Services Corporation, and (c) its Operating Agreement with the Transportation Center Owner shall be deemed to have been assumed. As soon as practicable after the Effective Date, Reorganized Debtor shall cure all defaults, if any, existing under such executory contracts, or shall provide adequate assurances, reasonably acceptable to the parties to such executory contracts, that such defaults shall be cured within a reasonable period. All other executory contracts to which the Debtor is a party shall be deemed rejected by the Debtor as of the Effective Date pursuant to Section 365(a) of the Code.

7.2 The provisions of Section 5.11 of the Plan to the contrary notwithstanding, all leases with tenants of the Property on which the Debtor is the lessor which are not expressly rejected under the Plan or by order of Court prior to the Effective Date shall be deemed assumed as of the Effective Date pursuant to Section 365(a) of the Code, except for Debtor's lease with Rudnick & Wolfe, which lease shall be assumed as of the Effective Date, as modified pursuant to the First Amendment to Lease between the Land Trust, as landlord, and Rudnick & Wolfe, as tenant (which First Amendment is contemplated in the April 7, 1995 letter from Marc R. Wilkow to Rudnick & Wolfe, a copy of which is attached hereto as

Exhibit B), and in connection with said assumption, Bank shall enter into mutually acceptable attornment, non-disturbance, and subordination agreements with Rudnick & Wolfe; provided, however, that if the Bank and Rudnick & Wolfe fail to enter into such agreements within 5 business banking days after the Effective Date, the Court shall conduct an expedited hearing and shall direct the said parties to enter into and execute such attornment, non-disturbance and subordination agreements as the Court finds to be commercially reasonable.

7.3 Proofs of Claim for damages arising out of the rejection of executory contracts or unexpired leases shall be filed within thirty days after the Effective Date in accordance with Section 502(g) of the Code.

8. MODIFICATION OF THE PLAN

8.1 Modification of the Plan may be proposed in writing by the proponent at any time before confirmation, provided that the Plan, as modified, meets the requirements of Sections 1122 and 1123 of the Code and that the proponent shall have complied with Section 1125 of the Code.

8.2 After confirmation of the Plan, and with Court approval after notice to all Creditors, the Reorganized Debtor shall be permitted to modify any one or more provisions of the Plan, provided, however, that by agreement between Reorganized Debtor and Bank, this Plan may be modified without approval of the Court, following reasonable notice to all Creditors.

9. CONFIRMATION NOTWITHSTANDING REJECTION

9.1 Debtor reserves its rights under Section 1129(b) of the Code to seek confirmation of the Plan notwithstanding rejection of the Plan by one or more classes.

10. RETENTION OF JURISDICTION

10.1 After the Effective Date, the Court shall retain jurisdiction over the Case only for the following limited purposes:

a. Allowance or disallowance of any and all Claims, including, without limitation, administrative Claims pursuant to Section 507(a)(1) of the Code, and determination of any objections to Claims regardless of whether said objections are filed before or after the Effective Date;

b. Effectuating, modifying, interpreting and enforcing the terms of the Plan (and all documents executed in connection therewith), including, without limitation, modifications, extensions, and restructurings, as set forth in Section 4.1(b) above, and resolving any disputes concerning the interpretation or implementation of the Plan (and all documents executed in connection therewith);

c. Hearing and concluding any contested matters, whether pending on the Effective Date or thereafter filed;

d. Effectuating any liquidation of Reorganized Debtor;

e. Entering an order closing this Case.

203 NORTH LASALLE STREET PARTNERSHIP, an Illinois limited partnership

By: North LaSalle Street Limited Partnership, an Illinois limited partnership

By: M & J Equities, Ltd., an Illinois limited general partnership (a general partner)

By: MJW Investments, Ltd., a Delaware corporation formerly known as M & J Wilkow, Ltd. (general partner)

By:/s/ Marc R. Wilkow
Its: President

With Respect To The Covenant Contained In Section 5.3(b)

/s/ Marc R. Wilkow
Marc R. Wilkow

With Respect To The Covenant Contained In Section 5.3(c)

M & J Wilkow, Ltd.

By:/s/ Marc R. Wilkow
Its: President

M & J Wilkow Brokerage Services Corporation

By:/s/ Marc R. Wilkow
Its: President

Richard M. Bendix, Jr.
Paul J. Gaynor
SCHWARTZ, COOPER, GREENBERGER & KRAUSS, CHARTERED
180 North LaSalle St., Ste. 2700
Chicago, Illinois 60601
(312) 346-1300

EXHIBIT A

(Legal description)

EXHIBIT "B" TO JOINT DECLARATION OF EASEMENTS, RESERVATIONS, COVENANTS AND RESTRICTIONS FOR THE LOOP TRANSPORTATION CENTER AND 203 NORTH LASALLE OFFICE BUILDING, CHICAGO, ILLINOIS

Legal Description of Office Building Parcel

See the following 10 pages

OFFICE BUILDING PARCEL

AREA 1

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +162.75 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE NORTH 0 DEGREES 47 MINUTES 09 SECONDS WEST, ALONG THE EAST LINE OF LOT 4 AFORESAID, 62.55 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 0 DEGREES 47 MINUTES 09 SECONDS WEST, ALONG THE EAST LINE OF LOT 4 AFORESAID, 24.25 FEET; THENCE SOUTH 90 DEGREES

00 MINUTES 00 SECONDS WEST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 28.68 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 24.25 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 29.02 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 2

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +135.08 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, and 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 97.72 FEET TO THE PLACE OF BEGINNING; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00

MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 40.67 FEET, TO A LINE DRAWN 1.50 FEET NORTH OF AND PARALLEL WITH THE NORTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID; THENCE NORTH 89 DEGREES 50 MINUTES 19 SECONDS WEST, ALONG THE LAST DESCRIBED LINE, 76.05 FEET TO THE EAST LINE OF N. LA SALLE ST. AFORESAID; THENCE SOUTH 0 DEGREES 53 MINUTES 02 SECONDS EAST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 52.50 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 3

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +136.50 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53

MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 97.73 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.94 FEET TO THE POINT OF BEGINNING; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 30.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 49.52 FEET TO A LINE DRAWN 1.50 FEET NORTH OF AND PARALLEL WITH THE NORTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID; THENCE NORTH 89 DEGREES 50 MINUTES 19 SECONDS WEST, ALONG THE LAST DESCRIBED LINE, 30.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 49.61 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 4

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +140.08 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN

DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 97.72 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.94 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 30.00 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 75.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 49.31 FEET TO A LINE DRAWN 1.50 FEET NORTH OF AND PARALLEL WITH THE NORTH LINE OF LOTS 5, 6, AND 7 IN BLOCK AFORESAID; THENCE NORTH 89 DEGREES 50 MINUTES 19 SECONDS WEST, ALONG THE LAST DESCRIBED LINE, 75.00 FEET; THENCE SOUTH 0

DEGREES 00 MINUTES 00 SECONDS WEST 49.52 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 5

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +143.00 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID, ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7, IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 97.72 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET;

THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.94 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 105.00 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 30.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 49.23 FEET TO A LINE DRAWN 1.50 FEET NORTH OF AND PARALLEL WITH THE NORTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID; THENCE NORTH 89 DEGREES 50 MINUTES 19 SECONDS WEST, ALONG THE LAST DESCRIBED LINE, 30.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 49.31 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 6

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +145.92 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE

OF N. LA SALLE ST. AFORESAID, 97.72 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.94 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 135.00 FEET TO THE PLACE OF BEGINNING; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 1.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 91.91 FEET TO THE EAST LINE OF LOT 3 IN THE SUBDIVISION OF LOT 8 AFORESAID; THENCE NORTH 0 DEGREES 47 MINUTES 09 SECONDS WEST, ALONG THE EAST LINE OF LOTS 1, 2, AND 3 IN THE SUBDIVISION OF LOT 8 AFORESAID, 50.31 FEET TO THE NORTHEAST CORNER OF LOT 1 AFORESAID; THENCE NORTH 89 DEGREES 50 MINUTES 19 SECONDS WEST, ALONG THE NORTH LINE OF SAID LOT 1 AND ALSO ALONG A LINE DRAWN 1.50 FEET NORTH OF AND PARALLEL WITH THE NORTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, A DISTANCE OF 91.22 FEET TO A POINT ON A LINE DRAWN FROM THE HEREINABOVE DESIGNATED PLACE OF BEGINNING, SAID LINE BEING PERPENDICULAR TO THE SOUTH LINE OF BLOCK 18 AFORESAID; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG SAID

PERPENDICULAR LINE, 49.23 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 7

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING ABOVE ELEVATION +146.25 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: BEGINNING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 97.72 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET;

THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.94 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 135.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 1.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 91.91 FEET TO THE EAST LINE OF LOT 3 IN THE SUBDIVISION OF LOT 8 AFORESAID; THENCE SOUTH 0 DEGREES 47 MINUTES 09 SECONDS EAST, ALONG THE EAST LINE OF LOTS 3 AND 4 IN THE SUBDIVISION OF LOT 8 AFORESAID, 12.25 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 28.68 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 24.25 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 29.02 FEET TO THE EAST LINE OF LOT 4 AFORESAID; THENCE SOUTH 0 DEGREES 47 MINUTES 09 SECONDS EAST, ALONG THE EAST LINE OF LOT 4 AFORESAID, 62.55 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 8

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW ELEVATION +146.25 FEET AND LYING ABOVE ELEVATION -13.50 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE

SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 97.72 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 44.99 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 3.33 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 2.31 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.44 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.94 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 0.44 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.33 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 27.50 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.50 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 15.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.83 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 12.50 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 9

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW ELEVATION +146.25 FEET AND LYING ABOVE ELEVATION -5.50 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 81.51 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 47.49 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE 27.50 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.42 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 27.50 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 7.42 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 10

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW ELEVATION +146.25 FEET AND LYING ABOVE ELEVATION +1.75 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 60.43 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 47.16 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE, 27.50 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 7.42 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 27.50 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 7.42 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 11

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW ELEVATION +146.25 FEET AND LYING ABOVE ELEVATION +1.75 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LA SALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LA SALLE ST. AFORESAID, 40.47 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 46.85 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE, 18.29 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 8.33 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 18.29 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 8.33 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 12

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW A HORIZONTAL PLANE OF ELEVATION +33.75 FEET AND LYING ABOVE A HORIZONTAL PLANE OF ELEVATION +15.25 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LASALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LASALLE ST. AFORESAID, 48.80 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 45.73 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE, 28.42 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 11.62 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 28.42 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 11.62 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 13

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW A HORIZONTAL PLANE OF ELEVATION +33.75 FEET AND LYING ABOVE A HORIZONTAL PLANE OF ELEVATION +15.25 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LASALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LASALLE ST. AFORESAID, 67.84 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 46.03 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE, 32.50 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 13.67 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 32.50 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 13.67 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 14

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW A HORIZONTAL PLANE OF ELEVATION +33.75 FEET AND LYING ABOVE A HORIZONTAL PLANE OF ELEVATION +15.25 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LASALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LASALLE ST. AFORESAID, 88.93 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 46.35 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE, 28.42 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 11.62 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 28.42 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 11.62 FEET TO THE PLACE OF BEGINNING,

ALSO

AREA 15

THAT PART OF VARIOUS LOTS (TOGETHER WITH ADJOINING ALLEYS) LYING BELOW A HORIZONTAL PLANE OF ELEVATION +48.92 FEET AND LYING ABOVE A HORIZONTAL PLANE OF ELEVATION +15.25 FEET CHICAGO CITY DATUM, IN BLOCK 18 IN THE ORIGINAL TOWN OF CHICAGO, IN THE SOUTHEAST 1/4 OF SECTION 9, TOWNSHIP 39 NORTH, RANGE 14 EAST OF THE THIRD PRINCIPAL MERIDIAN DESCRIBED AS FOLLOWS: COMMENCING AT THE SOUTHEAST CORNER OF LOT 4 IN THE SUBDIVISION OF LOT 8 IN THE AFORESAID BLOCK 18, THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST, ALONG THE SOUTH LINE OF LOTS 4, 5, 6, AND 7 IN THE SUBDIVISION OF LOT 8 AFORESAID ALSO ALONG THE SOUTH LINE OF LOTS 5, 6, AND 7 IN BLOCK 18 AFORESAID, 302.00 FEET TO THE EAST LINE OF N. LASALLE ST. AS WIDENED BY ORDINANCE PASSED DECEMBER 23, 1924; THENCE NORTH 0 DEGREES 53 MINUTES 02 SECONDS WEST, ALONG THE EAST LINE OF N. LASALLE ST. AFORESAID, 53.17 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PARALLEL WITH THE SOUTH LINE OF BLOCK 18 AFORESAID, 7.63 FEET TO THE PLACE OF BEGINNING; THENCE CONTINUING NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG THE LAST DESCRIBED LINE, 4.17 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST, ALONG A LINE DRAWN PERPENDICULARLY TO THE SOUTH LINE OF BLOCK 18 AFORESAID, 0.67 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 1.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 1.00 FEET; THENCE

NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 22.50 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 1.00 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 1.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 0.67 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 3.50 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 5.62 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 10.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 54.25 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 10.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 5.62 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 3.50 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 0.67 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 1.00 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 1.00 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 22.50 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 1.00 FEET; THENCE NORTH 90 DEGREES 00 MINUTES 00 SECONDS EAST 1.00 FEET; THENCE NORTH 0 DEGREES 00 MINUTES 00 SECONDS EAST 0.67 FEET; THENCE SOUTH 90 DEGREES 00 MINUTES 00 SECONDS WEST 4.17 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 6.23 FEET; THENCE SOUTH 45 DEGREES 00 MINUTES 00 SECONDS WEST 7.07 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 20.54 FEET; THENCE SOUTH 45 DEGREES 00 MINUTES 00 SECONDS EAST 7.07 FEET; THENCE SOUTH 0 DEGREES 00 MINUTES 00 SECONDS WEST 6.23 FEET TO THE PLACE OF BEGINNING, IN COOK COUNTY, ILLINOIS.

EXHIBIT B

M & J WILKOW

April 7, 1995

VIA FACSIMILE

Rudnick & Wolfe
203 North LaSalle Street
Suite 1800
Chicago, Illinois 60601

Attention: Lee I. Miller

Re: 203 North LaSalle Street

Gentlemen:

Set forth below are the terms upon which a general understanding has been reached with your Policy Committee subject to: (i) approval by the partners of Rudnick & Wolfe, (ii) the approval of a Plan of Reorganization, incorporating the documents referred to in (iii) and (iv), acceptable to the Landlord's beneficiary, (iii) full execution of a definitive Lease Amendment and (iv) full execution of an acceptable Subordination, Non-Disturbance and Attornment Agreement with mortgage lien holder.

Space:	Existing premises consisting of 158,124 r.s.f.
Commencement:	As soon as practicable following the approval of a Plan of Reorganization with a January 1, 1995 effective date.

Extension Term:	The existing lease will be extended for seven (7) years.
Cash Allowance:	Within five (5) business days of the execution of a Lease Amendment, Landlord shall remit the sum of $1,000,000 to the Tenant and Tenant shall receive three (3) cash payments of $116,000 on the first, second and third anniversary date of the execution of the Lease Amendment. The Landlord's failure to remit payment on a timely basis shall give rise to a right of offset against next due rent on a dollar-for-dollar basis by the Tenant.
Rent Abatement:	Tenant shall be entitled to an annual rental abatement for the calendar years 1995 through 1999 in an amount equal to $850,000, prorated on a monthly basis. For 1995, the amount of the annual rental abatement "earned" as of the date of the Lease Amendment shall be applied as a credit against annual base rent which is next due and payable during 1995.
Extension Term Rent:	Annual base rent for the first lease year of the extension term will be based on $16.00 per square foot. Thereafter, 35% of the Annual Base Rent shall be subject to annual increases based on increases in the Consumer Price Index from and after the commencement date of the

extension period (in accordance with the formula incorporated into the existing lease terms). The base Consumer Price Index shall be the Consumer Price Index as of January, 2000. Increases in the annual base rent as a result of increases in the Consumer Price Index shall not exceed three (3%) per year percent on a cumulative basis.

Tenant Improvements, Equipment:	Tenant agrees that during the balance of the original term, it will expend an average amount of at least $150,000 per year on upgrades and modifications to the Premises and equipment serving its business from the Premises.
Expansion Options:	Tenant shall have an option to expand by leasing suites 1650 (3,900 r.s.f.), and/or 1630 (3,229 r.s.f.) and/or 1610 (11,669 r.s.f.) as of June 1, 1998 upon not less than nine months' prior written notice; provided, however, that suite 1610 shall only be made available by the Landlord if the existing tenant elects to exercise its right to cancel its lease on or before October 1, 1997. Tenant shall also have the additional right to expand by leasing all or a portion of suite 2000 (39,787 r.s.f.) as of December 31, 2002 upon not less than nine months' prior written notice; provided, however, that in the event

that the option is exercised as to less than all of the space, the space which is not the subject of the option must be as marketable as the space which Tenant elects to lease and, provided, further, that in no event shall Tenant be allowed to exercise this option for less than 20,000 r.s.f. Except where herein provided to the contrary, the provisions of the existing lease (including, without limitation, build-out allowance and rent calculation) shall continue to apply to the exercise of the expansion options.

Security: A mutually acceptable arrangement will be established, in the nature of a letter of credit or an escrow, which shall enable the Landlord to retain as security for Tenant's obligations under the Lease, an amount which shall be funded as follows:

Date	Deposit	Cumulative
Lease Amendment	$ 650,000	$ 650,000
January 1, 1996	350,000	1,000,000
January 1, 1997	350,000	1,350,000
January 1, 1998	350,000	1,700,000
January 1, 1999	300,000	2,000,000

Provided that the Tenant is not in default, the amount of the security shall be partially released as follows:

	Amount Released	Outstanding Balance
March 1, 2003	$ 500,000	$ 1,500,000
March 1, 2004	500,000	1,000,000
March 1, 2005	1,000,000	0

Renewal Option: Adjusted for the seven-year extension term, the Tenant shall have the option to renew the lease based on its existing lease terms.

Commission for Tenant's Agent: Equis Corporation will be paid a commission for services rendered in connection with the extension of the Lease in an amount agreed to by Marc Wilkow and Michael Silver.

If a Plan of Reorganization incorporating the matters described in the introductory paragraph of this letter is not approved on terms acceptable to the Landlord's beneficiary by August 1, 1995, then in the absence of a written agreement signed on behalf of both parties, this agreement shall become null and void without further action of either party hereto. Please indicate your agreement to the terms hereof by signing and returning a copy of this letter to me prior to 5:00 p.m. on Monday, April 10, 1995.

Very truly yours,
M & J WILKOW BROKERAGE
SERVICES CORPORATION

By:/s/ Marc R. Wilkow
Marc R. Wilkow
President

MRW:sbr
cc: Michael Silver
Errol R. Halperin
Charles L. Edwards

AGREED TO AND APPROVED:
RUDNICK & WOLFE

By:/s/ Lee I. Miller
Lee I. Miller
Managing Partner

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

(Title omitted in printing)

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE EUGENE R. WEDOFF
December 5, 1995, 1:30 P.M.

* * * * *

[Tr. 13] * * * * THE COURT: Mr. Kiriakos, I have read the proposed order that you came up with and I see clearly how you attempted to address the concerns that were raised yesterday. I'm not confident that it does address all the concerns, and perhaps I share Mr. Bendix's overall position that it may no be possible to address all the concerns that may come up. There are a number of parties who are affected by confirmation of this plan.

On the other hand, Mr. Bendix, I disagree with you very pointedly on one issue. That is whether the order is going to affect — the confirmation order going into effect will moot any appeal. I have had the opportunity this morning to review the Specialty Equipment Company case, the Seventh Circuit decision dealing with this question of mootness. And the court by no means holds that the confirmation of a plan or even its substantial consummation automatically moots an appeal from a confirmation order. In fact it holds to the contrary. It says that's something that has to be determined on the facts of each case. And in particular one of the factors that is to be [Tr. 14] considered is whether or not the party opposing confirmation sought a stay.

Now in this case the bank obviously has done everything it could to have this order stayed prior to the time that it would go into effect, short of giving you a blanket indemnification, and every party who may be involved in this case a blanket indemnification, and I suppose supported by some enormous bond. The bank really has, I think, done what it needed to do procedurally to preserve this issue. But beyond that, Specialty Equipment Company was some sort of manufacturing concern. The Seventh Circuit's opinion does not go into any great detail as to what its business was. But this was some kind of manufacturing concern with suppliers and debenture holders and an ongoing business of some sort prior to the time the bankruptcy took place. It was not a single asset real estate case.

The main function of your plan is to continue a relationship between the debtor as borrower and the bank as lender restructuring the terms of the loan. If the plan goes into effect and it later is reversed on appeal, it seems to me that the effect of the confirmation can be fairly easily undone simply by the bank repaying to your investors [Tr. 15] the amount of their cash contributions. The fact is the bank had announced previously in this case it intended to pay the trade creditors in the event there was no confirmation. Whether that was a binding promise or not I don't know, but there's certainly a representation made to that effect.

The bank made it clear, I believe, that it was willing to purchase the claims of the trade creditors. The bank obviously would be paying the real estate tax regardless of whether this case is confirmed. And the bank has also made it clear that it consents to the lease to Rudnick & Wolfe. Prior to confirmation the bank was in a position to approve leases, I would imagine, under the terms of its loan agreement with the debtor. Under the plan as confirmed it will similarly have the opportunity to review and approve leases.

So I frankly don't see as I look at this case why you come to the conclusion that confirmation would automatically moot an appeal.

MR. BENDIX: Well, Your Honor, I have successfully gotten two appeals from confirmation orders dismissed as moot.

THE COURT: Single asset real estate cases?

MR. BENDIX: Not single asset cases. We are

* * * * *

[Tr. 17] * * * * THE COURT: Well, you know, if you feel that you need to make a record, Mr. Bendix says he wants to make a record, you may want to make a record. But we get back in my judgment to the initial question that faces the court in determining whether to grant this kind of relief. That is the kind of balance of the harms analysis. I made the remarks that I made yesterday taking at face value the assertion that failure to stay this order would result in mootness. As I considered that question in my sleeplessness last night the question came to me, "Why is this moot." And I am persuaded that there are substantial differences between the reorganization of an operating manufacturing business and a single asset real estate case.

The relationship between the lender and the debtor in a single asset real estate case is by [Tr. 18] far the most significant relationship in this case. The other creditors have relatively small roles to play. The main thrust of this plan, as I indicated just a moment ago, is the restructuring of the financing relationship between the lender and the bank. And I frankly don't see why that can't be undone in the event that the confirmation is overturned.

What will happen in that event is that the note will be canceled. The bank will be in a position of having its rights

to foreclose on its original note. And the other parties who are affected basically will have been benefited to some extent at the bank's expense, because my understanding would be that the bank would be required to return to the investors the money that they had invested in the enterprise with some sort of reasonable interest. But that seems to me would be a remedy that would make the debtor's investors whole, and no one else has been harmed.

MR. KIRIAKOS: I understand, Your Honor.

Your Honor, my second concern is that, as Mr. Bendix points out, rule 8005 directs us to you in the first instance for a stay pending appeal. I am concerned that if I don't have an opportunity [Tr. 19] now to seek a stay at the district court level, that that will somehow be held against me under --

THE COURT: You will certainly have the opportunity to proceed to the district court. If I deny the request this afternoon you may go to the district court immediately, it seems to me. And the district court if it wishes to hear evidence on this matter may enter a temporary stay of the effectiveness of the order. So I don't think you will be prejudiced.

As far as putting on a record, it seems to me that that really is a decision that the district court ought to make. The district court certainly has the capacity to hear evidence in this matter. And I would rather let the district court make the decision as to what evidence is going to be relevant. If the district court agrees with me that this is a situation where there is very little likelihood of the appeal being rendered moot by substantial consummation of the plan, then the district court may determine that it can deny the request for stay without an evidentiary hearing.

On the other hand if the district court feels that mootness, contrary to my view of the situation, is a real possibility and considers that [Tr. 20] to be substantial harm, then a stay might be appropriate. Then the district court may well want to hear evidence as to the harm that might occur if the stay is imposed. But as I look at the situation that is not a relevant consideration. I am inclined to make my decision denying the request for the stay not on the ground that there's substantial harm to the debtor and other parties in the case that cannot be addressed by an appropriate order, but because I don't see the harm to the bank, which is the predicate for the request for the stay.

MR. BENDIX: Your Honor, I still, and I appreciate all of Your Honor's arguments, if Your Honor, as I hope you will, denies the motion, the mootness issue is going to be decided by the district court, and perhaps the Court of Appeals. I would like them to have the benefit of hearing from two people the harm that they will suffer if there was a stay that was entered and —

THE COURT: I think I'm getting the picture here. You've got your witnesses now and you won't have to bring them back to the district court. It's not going to impact on my decision whatever. If you want to have these witnesses testify so you can have a transcript that you can deliver to the district [Tr. 21] court in response to any request that the bank may make, you're welcome to take those witnesses' testimony.

The only concern I have is that I have a 2:00 o'clock hearing. As I say, it's not going to impact my decision. As far as I am concerned you can go next-door in Judge Barliant's courtroom and take the testimony there before the court reporter. It's not relevant —

Oh, he's got a hearing going on too?

MR. BENDIX: Your Honor, it will take ten minutes. I appreciate Your Honor's indulgence. I'll make it as quick as possible.

THE COURT: Call your witness.

(Witness sworn.)

RICHARD HANSON, WITNESS, SWORN

DIRECT EXAMINATION

BY MR. BENDIX:

Q: State your name for the record, please. A: Richard Hanson.

Q: What is your present position, Mr. Hanson? A: I'm the managing director at Stein & Company.

Q: Are you an investor in the debtor, and [Tr. 22] potentially the reorganized debtor? A: Yes, I am.

Q: Are there other persons affiliated with what's known as the Stein Group that are also investors? A: Yes, there are.

Q: Who are they? A: Richard Stein and Myron Warshauer and affiliated companies.

Q: What's the amount of the Stein Group investment in the reorganized debtor? A: Just under $2 million.

Q: What form does that take? A: We have $500,000 of cash in an escrow account and we have notes for the remaining balance of about $1,490,000.

Q: What's your position if a stay would be entered in this case? A: Well, the important fact for us with regard to the case is the certainty that there will be no triggering of the negative capital accounts caused by the lack of certainty in this

situation. And to the extent that we do not have certainty in the case, myself and my partner will have the opportunity to, since our cash is only in the [Tr. 23] account, in the escrow account through 12/31/95, we'll have to make our own decisions with regard to ways that we can protect ourselves from the taxable situation caused by a transfer of the property.

We are right now negotiating for the sale of the two buildings that we have which will eliminate all of our loss carryforwards. And I have made a personal calculation of my own tax situation, and if this building title moves I would have personal tax liability in excess of $1 million. And I can't take the chance that with the stay and the unknown situation with what might occur, that I could be faced with that liability. So I would have to begin to look for alternate situations to protect myself from tax liability.

Q: If you found such an alternate situation what might you do? A: Well, I would use the $500,000 of cash that I have now. If this isn't confirmed I would take the $500,000 of cash, have the opportunity to regain, plus those notes, and I would use that money to find other tax losses or other ways to shelter my gain.

Q: You said confirmed. Do you mean effective? [Tr. 24] A: Effective, with certainty.

Q: Did you take any steps in reliance on the plan being confirmed? A: Yes. We, in effect, believing the plan was confirmed have agreed to go through with the sale of the AT&T and USG Buildings which would result in millions of dollars in gain to us.

Q: What's the consequence if that gain occurs? A: Well, we will lose all of our tax loss carryforwards and leaves us in a totally negative situation where any more gains would create an immediate tax liability.

MR. BENDIX: No further questions, Your Honor.

CROSS-EXAMINATION

BY MR. KIRIAKOS:

Q: How do you lose title to this property if there is a stay pending appeal? A: I don't, but I don't have any certainty that I won't.

Q: And why — how could you? During the stay pending appeal how could you lose title to the property? A: No, that would —

[Tr. 25] THE COURT: It would be a reversal of my order of confirmation that would cause you to lose title.

THE WITNESS: Exactly.

BY MR. KIRIAKOS:

Q: With respect to the USG sale and the other sale that you testified to, haven't you been negotiating those for six months? A: No.

Q: No, you haven't been? And you wouldn't do those deals if the plan had not been confirmed? A: Repeat your question? I don't understand the question.

THE COURT: The question is if the plan had not been confirmed would you have gone ahead with these transactions.

THE WITNESS: We may or we may not have.

BY MR. KIRIAKOS:

Q: How many investments are you a limited partner of? A: 20.

Q: Why do you believe that you have the right to get the $3 million back? A: We have an agreement that the $500,000 of cash that we have up is in an escrow account and [Tr. 26] if this plan isn't confirmed by December 31st, 1995 I have the right to get the $500,000 back.

Q: Didn't you just testify that you took action based on the reliance the plan was confirmed? A: No, I don't think I did.

MR. KIRIAKOS: I don't have any other questions.

THE COURT: Fine.

Do you have any other questions, Mr. Bendix?

REDIRECT EXAMINATION

BY MR. BENDIX:

Q: Mr. Hansen, are there other people similarly situated to yourself? A: Well, yes. There are other people in the Stein Group similarly situated, me and — you know, the situation really is that all of us have to choose the steps that we need to protect ourselves. And with this, as I understand it, without certainty with regard to this matter we're going to have to go out and protect ourselves by finding other tax losses or doing things necessary to shelter the gain if this plan wouldn't be confirmed in our favor. And I would presume it would be the same for our [Tr. 27] other investors. I mean, it's just not myself. If other investors go out and do the same thing, there's other investors who can similarly withdraw their investments in this matter which would jeopardize all of us.

Q: If Mr. Wilkow died during the pendency of the appeal, would that have any effect on you or your investment? A: I would presume so. I know only for myself that if I died during this thing my estate would get a step up in basis and it

would no longer be necessary for me to make the investment because there would no longer be a tax liability.

Q: Somebody else would have to replace your share? A: Someone else would have to replace me if the same $6 million was to be made.

MR. BENDIX: No further questions.

MR. KIRIAKOS: I will keep it brief, Your Honor.

RECROSS-EXAMINATION

BY MR. KIRIAKOS:

Q: With respect to any of the other 20 limited partnerships that you are an investor in, are those throwing off losses? [Tr. 28] A: Minimally, yes.

Q: How many investors are involved in this deal? How many investors would have to — I'm sorry. How many investors are involved in this partnership? A: With regard to the Stein Group there's three individually and several small corporations.

Q: Would all of them have to die? A: No.

Q: Would one have to die to have a significant effect? A: All that would have to die, or find other means of shelter to avoid their own personal tax gains would just have to be enough so that whoever was left couldn't cover the gain. And it depends upon the size of that investor and what their circumstances were. I don't have knowledge of all the investors.

THE COURT: You mean couldn't cover the capital contribution.

THE WITNESS: The capital contribution, I'm sorry.

BY MR. KIRIAKOS:

Q: What if the capital contribution or the amount of capital contribution came in from some [Tr. 29] other source? A: If you could find another source to put it in.

MR. KIRIAKOS: That's all I have.

MR. BENDIX: No further questions, Your Honor.

THE COURT: You may step down. Thank you.

(Witness excused.)

MR. BENDIX: We will call Mr. Robert Wittebort, attorney for Chicago Building Maintenance.

I don't think you need to testify. As an attorney you can make a statement.

THE COURT: No, if he's going to testify as to facts he'll be sworn in.

(Witness sworn.)

ROBERT J. WITTEBORT, WITNESS, SWORN

DIRECT EXAMINATION

BY MR. BENDIX:

Q: State your name for the record, please. A: Robert J. Wittebort, Jr., W-i-t-t-e-b-o-r-t.

Q: You are associated with Chicago Building Maintenance? [Tr. 30] A: It's Chicago Building Services, Incorporated.

Q: I'm sorry. A: I'm executive vice president.

Q: Is Chicago Building Services a creditor in this case? A: Yes, we are.

Q: How much is owed? A: 22,600 and something dollars.

Q: Did a situation recently arise that gave your company an immediate need for the money it's entitled to under the plan? A: Yes.

Q: What is that? A: A month ago we were notified by our insurance brokerage that an audit of our worker's compensation insurance for last year had revealed more payroll than had been factored into the original estimate. Consequently we were given a bill for $38,000 more for worker's compensation premium for last year.

Q: What would the effect on your company be of a stay being entered and your company therefore was not getting paid dividends it would be receiving under the plan? [Tr. 31] A: Well, we don't have the money handy. We are a cash flow business with essentially no reserves. We have no debt but we don't have a pot of money to invade to pay this amount. Consequently we would no doubt get sued which would jeopardize our ability to do business because we have to have worker's compensation insurance to do business.

In addition, Near North Insurance, our broker, has indicated to us that if we don't pay promptly, by promptly they mean within roughly ten days, that they will lose the account of the insurance company that writes our insurance, which is a fairly substantial account to them. So they are putting us under enormous pressure to find some money.

MR. BENDIX: No further questions.

CROSS-EXAMINATION

BY MR. KIRIAKOS:

Q: How would you be harmed by a stay if the bank bought your client's claim tomorrow for the full face amount but allowed your client to still have discretion over matters such as voting the claim? A: I haven't given that any consideration. I don't know under what terms such a thing would [Tr. 32] happen. I can say that our immediate problem with respect to cash would be eased by getting the $22,600.

THE COURT: You may step down.

THE WITNESS: Thank you, Your Honor.

(Witness excused.)

MR. BENDIX: Thank you, Your Honor. I appreciate your indulgence.

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IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

(Title omitted in printing)

TRANSCRIPT OF PROCEEDINGS
BEFORE HONORABLE PAUL E. PLUNKETT
December 6, 1995, 5:00 p.m.

* * * * *

[Tr. 14] * * * * THE COURT: What is that, an open question is an argument in favor or against likelihood of success on the merits?

MR. KIRIAKOS: The bankruptcy judge stated he was of the view that in light of those open issues, and his position and his view in this respect is supported by the In re. Mader decision at 100 Bankruptcy Reporter 989, Northern District of Illinois, 1989, which we quote in our motion, that in light of the existence of those issues and the absence of controlling authority, that that factor weighed in favor of a stay pending appeal, and he was of the view, as stated on December 4th, that although he obviously felt that he was right or he wouldn't have decided that way, that the bank, in light of the fact that those were open issues, that the balance weighed in favor of the bank being afforded a meaningful opportunity to appeal.

THE COURT: So, below, you won on that issue, is that right?

MR. KIRIAKOS: Based on what he said on December 4th, yes, I believe we did, your Honor.

THE COURT: Where did you stub your toe then?

[Tr. 15] MR. KIRIAKOS: At the conclusion of the December 4th hearing, Judge Wedoff said that he was concerned; that the major factor he was concerned with of the four factor test was harm to the debtor and third parties.

He asked me how I proposed to address that. I gave him a laundry list of ways that the bank was prepared to address that.

He suggested that I sit down with the debtor's attorneys and try to come up with a consensual order on those points and continued the hearing until 1:30 yesterday afternoon.

When we went back in at 1:30 yesterday afternoon, Judge Wedoff stated that he had given the matter thought in the intervening 24 hours and he was of the conclusion that a stay was not necessary because he did not, based on his consideration of the Seventh Circuit decision of Specialty Manufacturers, he was of the view that the eggs could be unscrambled and, consequently, the bank would not be harmed in the absence of a stay, and he stated, and I'm quoting from Page 20 of the transcript: "I'm inclined to make my decision denying the request for a stay, not on the ground that there is substantial harm to the debtor and other parties in the case that cannot be addressed by an appropriate order but because I don't see the harm to the bank, which is the predicate for the request for the stay."

[Tr. 16] He then — well, actually, he had, before that statement, given us a laundry list of the ways in which the egg could be unscrambled, which led to his conclusion that we would not be harmed and not be subject to the risk of a mootness finding, although he did indicate, as I alluded to before, that an appellate court clearly was not bound by his view of the issue.

THE COURT: Okay. Thank you.

What is your view of the harm to the reorganization plan if I shut off the engine? Have you learned that there is some problem about the money that would be posted as capital contributions going away? Is that what is going to happen, as you see it?

MR. KIRIAKOS: Well, that's clearly the position that the debtor took below.

Our position was that we could address any harm in the following manner: First, the debtor is holding, in cash, approximately $3.1 million of pre-petition rents. The bankruptcy —

THE COURT: I'm sorry, of pre-petition what?

MR. KIRIAKOS: "Rents" from the property, your Honor.

THE COURT: Okay.

MR. KIRIAKOS: Judge Wedoff has found that that is property that belongs to the bankruptcy estate.

[Tr. 17] Under the plan, and this is the significant point, that money was contemplated to be used for several things: That's a source of funds that can be used to address any likely harm.

Second, and much more important, as I mentioned, the bank, under the plan, has a secured claim, secured by the building, in the amount of $54.5 million. The bank would agree, in order to address any possible harm, that the cash flow from that property could be used to address the harm; in essence, that it would permit its collateral to be used to fund anything that wouldn't be funded if either the $3 million that the partners have contributed in cash or any of their payments on the promissory notes, which, by the way, don't even begin

until the first year anniversary of the effective date and which do not exceed $625,000.00 a year, if any of those amounts are not available, the bank has agreed, has offered, that it would permit its cash collateral, the rents in which it has a security interest, to be used to pay those amounts.

Now, in order to avoid any harm to the debtor as a result of the bank's permitting its cash collateral to be used to pay those amounts, to protect the debtor from any harm from paying those amounts, the bank has agreed and offered that to the extent its cash collateral is used to pay an expenditure, that would not have to be paid in the [Tr. 18] absence of the stay, and to give you an example —

THE COURT: No; I've got the idea.

MR. KIRIAKOS: Okay. That the bank would agree that the debtor could have a deemed offset or a deemed reduction in the amount of the bank's secured note, which is $54.5 million.

So, in terms of what the bank is offering, basically, it is to allow its entire collateral, $54.5 million, with a cash flow that the Court found on page 6 of its memorandum of decision to be $4.1 million in 1996; $5.7 million in 1997; $5.3 million in 1998, and so on, and I won't read all of it, to stand behind it.

We think that, with respect to any harm that has been identified, that cash flow, coupled with the proffered offset right against the note, more than —

THE COURT: To offset the capital contributions if they walk away?

MR. KIRIAKOS: That's right.

THE COURT: But it doesn't, does it? I mean, you're talking about, they've got three million sitting there in pre-petition rents that you are saying, or I guess you are saying, "Okay, go ahead and use those if you need them," right?

MR. KIRIAKOS: Right.

THE COURT: And they also have got an income stream [Tr. 19] still, right?

MR. KIRIAKOS: Right.

THE COURT: Are you saying that they can use that, too?

MR. KIRIAKOS: That is exactly what I am saying.

THE COURT: And not pay you interest?

MR. KIRIAKOS: That is exactly what I am saying.

THE COURT: Then that, then, you say, offsets the $4.2 million or so that they would have gotten in capital contributions, plus those notes?

MR. KIRIAKOS: Right. And we are saying —

THE COURT: Which you don't value much.

MR. KIRIAKOS: — more, your Honor.

It's not only that they get to use it but they are deemed to have paid it to us.

THE COURT: Why? Why are you doing this? It sounds like you're paying too much, or, I mean, you're offering too much.

Why are you doing this?

I don't understand why the bank thinks it's getting such a — well, what you are basically saying is, "We are willing to bet another five or six million dollars on the fact that we are just getting totally crushed by this confirmation deal," and I don't understand quite why.

Do you think the appraisal is way off and it's [Tr. 20] really worth more than $54 million?

MR. KIRIAKOS: Yes, we do, your Honor.

THE COURT: That's it, huh?

MR. KIRIAKOS: Yes. We do.

THE COURT: Okay.

MR. KIRIAKOS: And also, your Honor, to be specific, to address the other part of your comment, we don't think we are at risk for $6.1 million because we don't think that these investors for whom the debtor proposed this plan, and the Court found, or for whose primary benefit the debtor proposed this plan, are going to withdraw $3 million in cash that they contributed or to repudiate $3.125 million in promissory notes because if they do, and if they do that irrevocably, then they have lost their interest in the partnership and, even if this plan is confirmed, they will suffer what they are afraid they are going to suffer, which is adverse tax consequences.

So we don't think that there is a realistic risk that —

THE COURT: Oh, you are saying the new money is coming from the old owners?

MR. KIRIAKOS: As the price of retaining their interest, which is the price of not suffering the adverse tax consequences that they are trying to avoid.

THE COURT: Okay.

[Tr. 21] MR. KIRIAKOS: So we don't think that that is a reasonable likelihood.

Now, the debtor put one of the investors on the stand yesterday for the purpose of testifying that it was, and I don't think that the investor's testimony on that point is dispositive but in the event that it is taken as being credible, we make the offer that I just outlined and we suggest that that offer, not only with respect to the partners' contribution but with respect to any other harm that the debtor can identify, is more than ample, with one exception, which I will get to right now.

More than —

THE COURT: Well, let's hear from them, Mr. Kiriakos.

MR. KIRIAKOS: Okay.

THE COURT: I've had kind of a long day today and I'm not going to be able to — I was told by Terry that this would take about a half an hour and it is obviously going to take more than that.

What's so magical about tomorrow? Suppose I don't decide this by Friday, has the world ended?

MR. BENDIX: Well, your Honor, what will happen is, we will — it's not an "emergency" in the sense that anything irreparable is going to happen to the bank; it's an emergency in that tomorrow — this is the last time before

* * * * *

[Tr. 36] rights of third parties which will be substantially harmed and that the bank has not offered in any acceptable way to alleviate that harm.

And there is an interest of the public interest. There are $2 million of taxes that will be paid shortly that won't get paid if this plan is stayed and will be paid under the plan.

So I would ask your Honor to deny the motion for a stay.

Thank you.

THE COURT: Thank you, Mr. Bendix.

MR. MISSNER: Judge, if I could make a few comments.

THE COURT: Sure.

MR. MISSNER: I'm David Missner. I'm a partner in the Rudnick & Wolfe firm.

THE COURT: Hello, Mr. Missner.

MR. MISSNER: Judge, we have about 500 employees that are affected by this decision today. We have got a lease that has about four years to run and we have negotiated an amendment to our lease, which, according to the confirmation order and the various decisions in the various briefs, is the linchpin of the plan.

There is a renegotiation —

THE COURT: It sounds like it's going to make you [Tr. 37] rich. The money all seems to be going to you.

MR. MISSNER: Well, here is the problem, Judge: We have to spend about $4 million in capital improvements in our space if we are going to stay.

THE COURT: Oh, I see.

MR. MISSNER: We have carpeting, we have computers, we have a lot of things we're going to do.

We really don't want to move. And the negotiation that we had, which the bank has approved — I mean, this isn't a contest about whether it's fair or not; everyone agrees that whatever our deal is, it's a fair deal under the circumstances. The debtor agrees and the bank said in its moving papers that they agree.

THE COURT: Okay.

MR. MISSNER: So, whether we're going to be rich or not is — I don't think we'll be rich, but, whatever it is, I mean, I didn't negotiate the deal and it is what it is.

THE COURT: All right.

MR. MISSNER: Now, one thing is for sure and that is that we want certainty. We want to know that we have a deal and we want to know that the deal is done because only then can we start looking for other space.

We like our space. We know it needs improvement. We are prepared to put the money in that it needs to be done.

* * * * *

[Tr. 44] If that was the correct legal standard, a stay pending appeal of a confirmation order could never be entered because that factor would always weigh in favor of the proponent of the plan.

Finally, with respect to the rights of third parties, I am at a loss to understand Rudnick & Wolfe's position. We stated below and will state now that we like the deal; we will make sure that they will get their money.

I tender to your Honor the way that we are ready to do that: We are putting forth the cash flow of the property, which the judge found is more than sufficient, if it doesn't go to us, to go to other people.

Moreover, the amount that Rudnick & Wolfe is supposed to get right away is a million dollars in cash and $875,000.00 in rent concessions.

If the Court does not agree with us that putting forth the cash flow of the property, which is substantial, is sufficient to make sure that Rudnick & Wolfe gets its money, we will post a bond to make sure that Rudnick & Wolfe gets its money.

In that sense, Rudnick & Wolfe is right. We want the deal. We are in favor of it being approved.

The way I proposed to your Honor before is more than sufficient to take care of it. If not, we will post a bond in the amount — whether it's a $1 million or $1.875 [Tr. 45] million.

With respect to unsecured creditors, it is only $90,000.00 in the aggregate.

To the extent that anybody needs the money tomorrow, we have offered to buy their claim. They get the cash tomorrow.

Moreover, in order to avoid any argument that we would then use that claim to undo their votes in support of the plan, we have stated that we would buy the claim but leave all indicia of ownership with respect to how that claim votes in bankruptcy with the holder of the claim, so there is absolutely no identifiable harm to a total of $90,000.00 in trade debt, and there isn't any other, in light of what we have put forward with respect to any other harm, that our offer — and it is putting our

money where our mouth is, to put the cash flow, the piece of collateral that is worth $54.5 million, at stake, certainly is, in my book, putting your money where your mouth is.

Finally, your Honor, they are just factually wrong when they say we get the benefit of $6 million; we get a pay down in the beginning of a million-odd, we get the excess cash flow but the entire $6 million doesn't go straight into our pocket.

Your Honor, there is a significant risk of harm to the bank. We have offered specific concrete ways to address [Tr. 46] any harm to any third parties.

I would submit again, based on the language I quoted from the transcript, that harm to third parties was not the defining characteristic of Judge Wedoff's decision, it was his view that we weren't subjected to any risk of being harmed —

THE COURT: I have to stop you there, Mr. Kiriakos, because my brain is going to turn off in five minutes and I want you to answer one question.

MR. KIRIAKOS: Yes, your Honor.

THE COURT: Tell me, in fifty words or less, what it is about this plan that was confirmed that rises to the level of an abuse of discretion, which, as I sort of define as I look at it and say "What?" — I mean, what is there specifically about it? Give me two of your best arguments that this is just an abuse of discretion to do this.

MR. KIRIAKOS: One argument or one instance, your Honor, is that to subject the bank to the risk, and the total risk, of what happens with respect to this property over a ten year term for the primary purpose, which is exactly what the bankruptcy judge found, primary purpose of letting partners

who, in the scheme of things, in the pecking order of legal priorities, are at the absolute bottom, to subject the bank to not being able to exercise its foreclosure right in a non-recourse loan situation and foreclose

* * * * *

[Tr. 49] Your Honor, we think that the balance of the harm clearly weighs in favor of staying this based on the conditions that the bank would agree to and we —

THE COURT: Mr. Kiriakos, I have a simple mind and I have been sitting here with your argument, trying desperately to figure out why it is the bank feels itself so badly off in this deal, and it can't be — I asked you, "Well, is it that you think the property is worth a lot more?" and you said, "Yes," but it can't be that if your own appraiser just made it a few million dollars more.

It must be — it must be that you read the market as such that, although this thing is going to generate money because it's rented, and probably will remain so, that it's going to continue in free fall in its value so that when you finally do get it, you are —

MR. KIRIAKOS: No, your Honor.

THE COURT: Well, then, if that's wrong then I don't get the harm.

MR. KIRIAKOS: Let me address that.

THE COURT: All right.

MR. KIRIAKOS: Let me just address that then.

We do think it's worth more. We do think we could get more if we were permitted to foreclose. Even if we were, we'd

still get a whole lot less than our debt so the debtor's equity holders aren't being harmed in that way.

[Tr. 50] We, although it's a factual issue and I have steered clear of it because I wanted to focus on legal issues which require a de novo review, we do not want to be in a ten year contractual relationship with the debtor.

We think the debtor has done things in terms of how it has managed this property that we don't want to be in bed with the debtor, but, first and foremost, we have an honest dispute as to value.

And I understand the point about the appraisers but sometimes you get appraisals that you, in your heart, hearts as business people, think are low, even if they are your people, and the value of the property is in the eye of the beholder and it is real property, and, outside of bankruptcy, it's the only recourse we have and that is entitled to some deference and that would arise based on our position as to irreparable harm.

MR. MISSNER: Your Honor, if can I make just a couple of remarks.

THE COURT: All right.

MR. MISSNER: I understand why your Honor is having trouble figuring this out. The bank here is not just the Bank of America; the bank's sole participation is participation in its loan to seven foreign banks. They, under the terms of their agreement, cannot agree on a restructuring of the —

[Tr. 51] MR. KIRIAKOS: Your Honor, I —

MR. MISSNER: Wait, let me finish, please.

MR. KIRIAKOS: That's nowhere in the record.

MR. MISSNER: But that's what is happening here.

THE COURT: I don't want to go outside the record, counsel.

MR. MISSNER: That's what is driving this, your Honor, that there is a participant —

THE COURT: Well, then just tell me that there is something driving this.

You've hinted at that before.

MR. MISSNER: Okay.

THE COURT: If it's not in the record, I don't want to hear about it.

MR. MISSNER: Let me just address your Honor's question then.

You asked how Judge Wedoff abused his discretion. An abuse of discretion is either a purely arbitrary decision, without regard to any legal standard, or one where, as you say, you look at it and say "What?"

The judge applied the law. They don't allege anything different. He applied the correct legal standard, or they say it may be a different standard but he applied a legal standard and he applied the facts to those standards.

They may not like the result. They don't like the

* * * * *

IN THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION

(Title omitted in printing)

REORGANIZED DEBTOR'S SUPPLEMENTAL STATUS REPORT ON PLAN OF REORGANIZATION

[Filed December 27, 1995]

203 North LaSalle Street Partnership ("Reorganized Debtor"), hereby submits the following Supplemental Report on the status of Debtor's Second Amended Plan of Reorganization Dated September 11, 1995, As Modified ("Plan"):

1. On December 6, 1995, the order confirming ("Confirmation Order") the Plan was entered on the Bankruptcy Court docket. The Effective Date of the Plan was December 7, 1995, the first business day after the Confirmation Order was docketed.

2. On December 15, 1995, the Reorganized Debtor filed a report ("Status Report") detailing the steps which the Reorganized Debtor had taken to implement the Plan during the period from December 7, 1995 through December 15, 1995. Attached hereto as Exhibit A is a supplement to the Status Report ("Supplemental Status Report") covering the period through December 27, 1995 and showing: (a) the Reorganized Debtor's obligations under the Plan, (b) the Plan section creating said obligations, (c) the deadlines for performing said

obligations, and (d) the dates the Reorganized Debtor performed said obligations.

203 NORTH LASALLE STREET PARTNERSHIP

By: /s/ Paul J. Gaynor
One of its Attorneys

Richard M. Bendix, Jr.
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Date: 12/26/95
10:55 AM

203 North LaSalle Street Partnership
Confirmed Plan of Reorganization Status Report

		Plan Section	Due Date	Date Completed
1. Implementation of the Plan of Reorganization ("Plan")				
A. Cash Payments and Transfers				
1. Non-Insider Trade Creditors (Class 4) - 41 Claims	$88,377.87	4.2	12/07/95	12/07/95
2. Rudnick & Wolfe First Amendment				
a. Lump Sum Payment	$1,000,000.00	7.2	12/07/95	12/07/95
b. 1995 Abatement	850,000.00	7.2	12/31/95	12/27/95
c. Equis Corp. Commission	400,000.00	7.2	12/07/95	12/07/95
d. M & J Wilkow, Ltd. Commission	181,000.00	7.2	1/6/96	
3. 1994 Real Estate Tax 1st Installment (Class 2)				
a. Original Amount Due	$2,277,257.39	3.2	1/6/96	12/27/95
b. Penalties & Interest	341,558.62	3.2	1/6/96	12/27/95
c. CD Interest & M & J Wilkow, Ltd. Funding	34,158.86	3.2	1/6/96	12/27/95

4. Bank of America ("BAI") (Class 3)				
a. Principal Reduction	$1,149,500.00	4.1	12/14/95	12/14/95
b. Commitment Fee	266,975.00	4.1	12/14/95	12/14/95
5. New Cash Account				
a. Excess Balance from "Pre-Petition Rents" Account	$846,029.10	5.10(a)	As soon as practicable after the Effective Date	Cash account paperwork being processed
6. Schwartz, Cooper, Greenberger & Krauss (Class I)	hearing to be held 12/28/95	3.1	On the Effective Date or as soon as prac thereafter	
B. Cash & Investment Accounts				
1. Depository Account (via Lockbox arrangement)		5.10(a)	As soon as practicable after the Effective Date	Cash account paperwork being processed
2. Operating (Disbursement) Account (if required)		5.10(a)		
3. Real Estate Tax Escrow Account		5.10(a)		
4. Trust Account (Investment Vehicle)		5.10(a)		

Date: 12/26/95
10:55 AM

203 North LaSalle Street Partnership
Confirmed Plan of Reorganization Status Report

	Plan Section	Due Date	Date Completed
1. Implementation of the Plan of Reorganization (continued)			
C. Rudnick & Wolfe First Amendment (see above for "Cash Payments")			
1. Signing of Amendment by Land Trust & Delivery to R&W	7.2	12/07/95	12/07/95
2. Receipt of $650,000 Letter of Credit	7.2	12/12/95	12/11/95
D. Bank of America (BAI) Documents to be Delivered			
1. Original $53,395,000 Amended and Restated Promissory Note	4.1	12/14/95	12/14/95
2. Original Collateral Assignment of Mgmt. and Brokerage Fees	5.2	12/14/95	12/14/95
3. Escrow Instructions - Deposit of Trustee's Deed	5.3(a)	12/14/95	12/14/95
4. Investor Notes - $3,125,000	4.1(b)	12/14/95	12/14/95
5. Original $1,250,000 Letter of Credit	5.2	12/14/95	12/14/95

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

(Title omitted in printing)

NOTICE OF FILING

To: See Attached Service List

PLEASE TAKE NOTICE that on 27th day of December, 1995 we filed with the Clerk of the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division, the **Reorganized Debtor's Supplemental Status Report on Plan of Reorganization** copies of which are hereby served upon you.

SCHWARTZ, COOPER, GREENBERGER & KRAUSS, CHARTERED

By: /s/ Paul J. Gaynor
One of Its Attorneys

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AFFIDAVIT OF SERVICE

I, Patti Klimasara, a non-attorney, hereby state under oath that I caused to be served true and correct copies of the foregoing Notice of Filing and the document referred to therein upon all parties on the service list via facsimile this 27th day of December, 1995.

/s/ Patti Klimasara
Patti Klimasara

Subscribed and sworn before me
this 27th day of December, 1995.

/s/ Darlene M. Wagner
Notary Public

SERVICE LIST

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
	)	
203 North LaSalle Street	)	
Limited Partnership,	)	Bankruptcy Case
	)	No. 95 B 4998
Debtor.	)	

FINAL DECREE

THIS MATTER coming to be heard upon 203 North LaSalle Street Partnership's ("Debtor") Motion for Entry of Final Decree; due notice having been given to all parties entitled thereto; and the Court having found that the estate of the Debtor has been fully administered.

IT IS HEREBY ORDERED THAT:

The above-captioned Chapter 11 case is closed: provided, however, that the case will be reinstated if the matter is reversed on appeal.

/s/ Eugene R. Wedoff
Eugene R. Wedoff
United States Bankruptcy Judge

ENTERED Dec. 28, 1995

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

(Title omitted in printing)

Honorable Paul E. Plunkett

AFFIDAVIT OF MARC R. WILKOW

State of Illinois)
) SS
County of Cook)

Marc R. Wilkow, being first duly sworn upon oath, deposes and states as follows:

1. I am the President of M & J Wilkow, Ltd. ("MJW"). MJW is the manager of the office portion of the property (the "Property") located at 203 North LaSalle Street in Chicago, Illinois, which Property is beneficially owned by 203 North LaSalle Street Partnership (the "Reorganized Debtor").

2. I am making this Affidavit in support of the Reorganized Debtor's Motion To Dismiss As Moot Bank of America, Illinois' appeal from the Bankruptcy Court's December 5, 1995 Order (the "Confirmation Order") confirming the Debtor's Second Amended Plan Of Reorganization Dated September 11, 1995, As Modified (the "Plan") filed in Case No. 95 B 04998 in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division. I have personal knowledge of the facts stated in this Affidavit and would testify thereto if called upon to do so as a witness.

3. Following entry of the Confirmation Order, certain partners contributed $3 million of cash and $3,125,000 of notes payable in five annual installments of $625,000 (the "Investor Notes") to the Reorganized Debtor pursuant to Section 5.2 of the Plan. Pursuant to §4.5(d) of the Plan, ownership interests in the Reorganized Debtor have been modified to equal the percentage of the capital contribution made by or on behalf of each partner pursuant to the Plan. This has resulted in a substantial change in the ownership of the Reorganized Debtor as compared to the ownership of the Debtor.

4. Following entry of the Confirmation Order, pursuant to Section 7.1 of the Plan, all of the Debtor's service agreements were deemed rejected. Thereafter, the Reorganized Debtor entered into service agreements with Arrow Uniforms, Inc., Chicago Window Cleaning Co., Facilities Management Co., Cinras Corporation, FMS Company, Millard Metal Maintenance, Pinkerton Security, Schindler Co., Specialty Water Co., and United Parcel Service. Services have been provided to the Reorganized Debtor pursuant to those agreements and have been paid for by the Reorganized Debtor. MJW is presently engaged in negotiations with twelve additional companies regarding the terms of new service agreements relating to the Property.

5. The principals of MJW, Clifton Wilkow, David Harvey and I, have personally guaranteed the obligations of MJW under the $1,250,000 letter of credit issued pursuant to Section 5.2 of the Plan to support the Investor Notes. MJW paid a fee of $18,750 to obtain the foregoing letter of credit. In addition, MJW has committed the entire unused portion of its line of credit in connection with the issuance of that letter of credit by LaSalle National Bank.

6. Following entry of the Confirmation Order, Sallie Fulwiler, an MJW employee who had served as the Property

Manager of two other properties, became the full time Property Manager for the Property. In addition, MJW hired Courtney Knapp as the Assistant Property Manager for the Property, and Rebecca Steffas as the Property Manager for the properties formerly managed by Sallie Fulwiler.

7. Pursuant to Section 7.2 of the Plan, the Reorganized Debtor has caused the trustee of the land trust which holds title to the Property to enter into a first amendment (the "First Amendment") to the lease with Rudnick & Wolfe. Pursuant to that First Amendment, Rudnick & Wolfe's lease for approximately one third of the net rentable space in the Property has been extended for seven years until the year 2007. In connection with the execution of the foregoing First Amendment, in addition to the commission paid to Equis, Rudnick & Wolfe's broker, the Reorganized Debtor paid M & J Wilkow Brokerage Services Corporation a $181,000 commission on December 27, 1995.

Further affiant sayeth not.

/s/ Marc R. Wilkow
Marc R. Wilkow

SUBSCRIBED AND SWORN TO
before me this 1st day of
February, 1996.

/s/ Judith A. Rozhon
Notary Public

Supreme Court, U.S.
FILED
JUN 26 1998
OFFICE OF THE CLERK

No. 97-1418

In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE PETITIONER

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67 pp

QUESTION PRESENTED

Whether the Bankruptcy Code authorizes a judge to confirm a Chapter 11 plan of reorganization that grants the pre-bankruptcy equity owners of a debtor an exclusive opportunity to retain or purchase an ownership interest in the reorganized debtor, but does not provide for full payment to a senior, objecting class of unsecured creditors.

RULE 24.1(b) AND 29.6 STATEMENT

The parties in the court of appeals were Petitioner Bank of America Illinois, now known, as a result of a merger, as Bank of America National Trust and Savings Association, and Respondent 203 North LaSalle Street Partnership, an Illinois limited partnership.

Petitioner Bank of America National Trust and Savings Association is a wholly owned subsidiary of BankAmerica Corporation, which is a publicly held company. On April 13, 1998, BankAmerica Corporation and NationsBank Corporation announced their intention to merge in the fourth quarter of calendar 1998. Bank of America National Trust and Savings Association has the following non-wholly-owned subsidiaries: 693327 Ontario Limited; BA Card Services, Inc.; BA Holding Company S.A.; BA Insurance Brokerage Inc.; BA Merchant Services, Inc.; BA Securities Investment Advisory Limited; Bank of America (Jersey) Limited; Bank of America Colombia; BJ Services Trust 1997-1; Inchroy Credit Corporation Limited; InverAmerica S.A.; Multi Banco S.A.; and Tiryns FSC, Inc.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

RULE 24.1(b) AND 29.6 STATEMENT ii

OPINIONS BELOW 1

JURISDICTION 1

STATUTE INVOLVED 1

STATEMENT 1

A. The Absolute Priority Rule 1

B. Factual Background 5

C. Proceedings In The Court Of Appeals 8

INTRODUCTION AND SUMMARY OF ARGUMENT 10

ARGUMENT 14

I. THE PLAIN STATUTORY LANGUAGE DOES NOT INCLUDE A NEW VALUE EXCEPTION 15

II. THE LEGISLATIVE HISTORY SHOWS THAT CONGRESS DID NOT PROVIDE FOR A NEW VALUE EXCEPTION TO THE ABSOLUTE PRIORITY RULE 26

TABLE OF CONTENTS - Continued

III. CONGRESS DID NOT ADOPT THE NEW VALUE EXCEPTION *SUB SILENTIO* WHEN IT ENACTED THE BANKRUPTCY CODE IN 1978 32

A. A New Value Exception Was Not An Established Part Of Bankruptcy Practice In 1978 33

B. The Bankruptcy Code Varies Considerably From The Bankruptcy Scheme That Spawned The *Case* Dicta 37

IV. A NEW VALUE EXCEPTION WOULD BE INCONSISTENT WITH FUNDAMENTAL BANKRUPTCY CODE POLICIES 41

CONCLUSION 50

TABLE OF AUTHORITIES

Cases **Page**

62 Cases v. *United States*, 340 U.S. 593 (1951) 18

A.V.B.I., Inc., In re, 143 B.R. 738 (C.D. Cal. 1992) 37, 39, 43

Almendarez-Torres v. *United States*, 118 S. Ct. 1219 (1998) 25

Associates Commercial Corp. v. *Rash*, 117 S. Ct. 1879 (1997) 5

Bates v. *United States*, 118 S. Ct. 285 (1997) 18

Blum v. *Stenson*, 465 U.S. 886 (1984) 24

Bonner Mall Partnership, In re, 2 F.3d 899 (9th Cir. 1993), cert. dismissed, 513 U.S. 18 (1994) 11, 18, 19, 22, 45

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Bryson Properties, In re, 961 F.2d 496 (4th Cir. 1992) 16, 47

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Connecticut Nat'l Bank v. *Germain*, 503 U.S. 249 (1992) 16

D&F Constr., Inc., In re, 865 F.2d 673 (5th Cir. 1989) 18

Dewsnup v. *Timm*, 502 U.S. 410 (1992) 24, 36, 41

Federal Support Co., In re, 859 F.2d 17 (4th Cir. 1988) 48

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Griffin v. *Oceanic Contractors, Inc.*, 458 U.S. 564 (1982) 26

John Hancock Mut. Life Ins. v. Route 37 Bus. Park, 987 F.2d 154 (3d Cir. 1993) 48

Kansas City Terminal Ry. Co. v. *Central Union Trust Co.*, 271 U.S. 445 (1926) 34

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TABLE OF AUTHORITIES - Continued

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Marine Harbor Properties v. *Manufacturer's Trust Co.*, 317 U.S. 78 (1942) 33

Mason v. *Paradise Irrigation Dist.*, 326 U.S. 536 (1946) 33

McKennon v. *Nashville Banner Co.*, 513 U.S. 352 (1995) 22

Morales v. *Trans World Airlines, Inc.*, 504 U.S. 374 (1992) 24, 25

Northern Pac. Ry. v. *Boyd*, 228 U.S. 482 (1913) 15

Norwest Bank Worthington v. *Ahlers*, 485 U.S. 197 (1988) . 2, 4, 11, 15, 18, 20, 27, 33, 35, 42, 44, 48

Oncale v. *Sundowner Offshore Services, Inc.*, 118 S. Ct. 998 (1998) 21

Patterson v. *Shumate*, 504 U.S. 753 (1992) . . 17, 24, 25

Pennsylvania Dep't of Corrections v. *Yeskey*, 66 U.S.L.W. 4481 (U.S. June 15, 1998) 18, 24

Pennsylvania Dep't of Public Welfare v. *Davenport*, 495 U.S. 552 (1990) 17, 24

Price Waterhouse v. *Hopkins*, 490 U.S. 228 (1989) . . . 21

TABLE OF AUTHORITIES - Continued

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Toibb v. *Radloff*, 501 U.S. 157 (1991) . . 17, 24, 26, 49

U.S. Bancorp Mortgage Co. v. *Bonner Mall Partnership*, 513 U.S. 18 (1994) 4

Union Bank v. *Wolas*, 502 U.S. 151 (1991) . . 17, 26, 40

United Sav. Ass'n v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) 35, 36

United States v. *Ron Pair Enterprises*, 489 U.S. 235 (1989) 17, 19, 25, 26, 28, 35, 36, 40

UNR Indus., Inc., In re, 20 F.3d 766 (7th Cir. 1994) . 43

W.A. Mallory Co., In re, 214 B.R. 834 (Bankr. E.D. Va. 1997) 43

Statutes **Page**

11 U.S.C. § 363 . . . . . 14, 43

11 U.S.C. § 506 17

11 U.S.C. § 506(a) 6

11 U.S.C. § 510(c) 25

11 U.S.C. § 1111(b) 6

11 U.S.C. § 1121 46

TABLE OF AUTHORITIES - Continued

11 U.S.C. § 1121(b) 7

11 U.S.C. § 1126(c) 2, 37

11 U.S.C. § 1126(e) 48

11 U.S.C. § 1129 . . . . . 1, 13

11 U.S.C. § 1129(a)(8) 1, 2

11 U.S.C. § 1129(b) 12, 15, 16, 18, 31, 39, 40

11 U.S.C. § 1129(b)(1) 2, 37

11 U.S.C. § 1129(b)(2)(A)-(C) 37

11 U.S.C. § 1129(b)(2)(B) . . . . . *passim*

11 U.S.C. § 1129(c) 7

28 U.S.C. § 1254(1) 1

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DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY (1993) 2, 16, 28, 34, 37, 41, 45, 46

TABLE OF AUTHORITIES - Continued

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STEPHEN G. BREYER, REGULATION AND ITS REFORM (1982) 29

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of a divided panel of the court of appeals (Pet. App. 1a-47a) is reported at 126 F.3d 955. The order of the court of appeals denying rehearing and denying rehearing en banc by a 5-5 vote (Pet. App. 48a-49a) is not reported. The opinion of the district court (Pet. App. 50a-101a) is reported at 195 B.R. 692. The opinion of the bankruptcy court (Pet. App. 102a-154a) is reported at 190 B.R. 567.

JURISDICTION

The judgment of the court of appeals was entered on September 29, 1997. Pet. App. 1a. A timely petition for rehearing was denied on November 25, 1997. Pet. App. 48a-49a. The petition for a writ of certiorari was filed on February 23, 1998, and was granted on May 4, 1998. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Pertinent portions of the text of 11 U.S.C. § 1129 are set out in the Addendum attached to this brief.

STATEMENT

A. The Absolute Priority Rule

The primary purpose of a Chapter 11 bankruptcy case is to determine whether a plan of reorganization can be judicially approved consistent with the statutory provisions protecting both debtors and creditors; and, if so, to confirm such a plan. To be confirmed, *each* plan, regardless of who proposes it, must satisfy the requirements of 11 U.S.C. § 1129. If the plan satisfies the thirteen requirements of subsection (a) of Section 1129, the plan may be confirmed, without regard to subsection (b) of the statute.

One of those thirteen requirements is that each class of impaired creditors — creditors whose legal rights have been altered and whose claims are not paid in full under the plan — has voted to accept the plan. 11 U.S.C. § 1129(a)(8). For a class to accept a plan, the Code requires an affirmative vote by creditors whose claims constitute more than half of their

class by number and hold at least two-thirds of the total value of the claims in that class. 11 U.S.C. § 1126(c). Allowing a plan to be confirmed on the basis of creditor *consent*, without any further requirement that a court find the plan "fair and equitable," was an important innovation when Congress replaced all prior bankruptcy laws with the comprehensive Bankruptcy Code of 1978. See DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 262 (1993).

The Code also supplies a means — known in bankruptcy parlance as "cramdown" — by which some plans can be confirmed even without the level of creditor consent required by subsection (a). That is the purpose of subsection (b) of Section 1129. If the only one of the thirteen requirements of Section 1129(a) that the plan does not satisfy is the class acceptance requirement of Section 1129(a)(8), the plan still may be confirmed if it "does not discriminate unfairly and is *fair and equitable* with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1) (emphasis added). Although "fair and equitable" is a phrase borrowed from pre-Code absolute priority cases, it is a defined term under the Code. The Code provides that a plan is "fair and equitable" as to a class of dissenting unsecured claims if, among other requirements, creditors with claims or interests junior to those of the dissenting class "will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii).

This is the absolute priority rule. It requires "that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988) (internal quotation marks omitted). The rule was originally a judicial development but since 1978 has been part of the Bankruptcy Code. *Ibid.*

Justice Douglas's opinion for the Court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), contained dicta that have been read to suggest that there was or is a new value exception to the absolute priority rule. *Ahlers*,

485 U.S. at 203. *Case* arose under Section 77B of the Bankruptcy Act of 1898 and presented the question — quite different from the question presented in this case — whether a plan of reorganization that *had* been consented to by 90% or more of each class of creditors and equity holders could be confirmed even though it did not afford a class of creditors absolute priority. 308 U.S. at 111-112. The absolute priority rule was understood at that time (contrary to its present meaning under the Code) to require that a court deny confirmation of a plan unless it was adjudged "fair and equitable," *even if* majorities of all classes of creditors had *consented*. The plan in *Case* failed that standard. To mitigate the potential harshness of a rule that allowed a small minority of dissenters to block confirmation of a plan to which most similarly situated creditors had consented, however, Justice Douglas wrote (308 U.S. at 121-122 (dicta)):

> [T]here are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. * * * Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made. * * * [T]o accord "the creditor his full right of priority against the corporate assets" where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

Case is universally cited as the precedent that "established" a new value exception to the absolute priority rule (Pet. App. 14a) — even though the Court in *Case* ***rejected*** a plan because it violated the absolute priority rule, and even though the Court's dicta seemed to address the circumstances in which a court might approve a plan over the objection of a ***minority*** of a class of creditors. A new value exception, if it exists on the authority of *Case*, would allow the debtor's pre-petition equity holders the exclusive right to retain an ownership interest in the reorganized debtor, despite not providing for a more senior and unconsenting class in full, if

a bankruptcy judge determines that they have made substantial new contributions in money or money's worth that are reasonably equivalent to the retained interest and necessary to a successful reorganization. Pet. App. 14a.

A new value exception — providing the debtor's pre-bankruptcy owners with an *exclusive* opportunity to retain their ownership interests — is difficult to reconcile with the language of Section 1129(b)(2)(B)(ii) of the Bankruptcy Code, adopted in 1978. On its face, the statute forbids confirmation of reorganization plans under which pre-petition equity holders receive or retain "any" property "on account of" their pre-petition interests in the debtor where a dissenting class of unsecured creditors is not being provided for in full. Proponents of the new value exception maintain, however, that it is not actually an "exception" but a "corollary" to the absolute priority rule, because the post-petition interests acquired under the plan by the debtor's pre-bankruptcy equity holders are received "on account of" the contributed new value instead of "on account of" their status as pre-bankruptcy equity holders. See Pet. App. 17a, 21a.[1] This Court has left open the question whether any new value exception exists. *Ahlers*, 485 U.S. at 203 n.3; *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 513 U.S. 18, 20 n.1 (1994).

[1] We mention this argument at this point only to explain the "corollary" terminology. There are counterarguments. For one, the "corollary" terminology can be seen as historically inaccurate. See Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. REV. 975, 1011 (1997) ("The new value exception functioned as an exception to the absolute priority rule, never as part of the absolute priority rule."). Also, under the current Code, opponents counter that the "corollary" argument still fails to bring the exception within the statute because the "property" being retained by the debtor's pre-bankruptcy equity holders in violation of the plain language of the statute is *not* the purchased interests themselves, but the *exclusive* right accorded by the plan to the debtor's pre-bankruptcy equity holders to purchase the new equity interests in the reorganized entity. They are granted that right based on their status as pre-bankruptcy equity holders. See Pet. App. 33a-35a (Kanne, J., dissenting); pp. 19-23, *infra*.

B. Factual Background

The debtor in this case, respondent 203 North LaSalle Street Partnership, is a real estate limited partnership whose principal asset is fifteen floors of an office building in downtown Chicago (the "Property"). Pet. App. 2a. The debtor owes petitioner (the "bank") more than $93 million; the debtor was required to repay the bank's loan, secured by a non-recourse first mortgage on the Property, in January 1995. *Ibid.* When the debtor was unable to repay the loan, the bank began foreclosure proceedings; shortly thereafter, the debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. *Ibid.*

When the bankruptcy court confirmed the debtor's plan of reorganization, the debtor was insolvent and the court valued the bank's secured claim at $54.5 million (the $55.8 million market value of the Property at the time, according to the court, minus the hypothetical cost of disposing of it).[2] The bank was thus left with an unsecured deficiency claim of

[2] In this case, as in most bankruptcy cases, the parties did not and do not agree on the valuation of the collateral. It is an indispensable feature of bankruptcy law that sometimes bankruptcy judges must "resolve" such disputes by "finding" the value of assets. Yet it is impossible to understand the policy implications of the new value debate (or of many other bankruptcy issues) unless one comprehends that the judge's finding does not, in any real-world sense, "establish" for all purposes the one true value of the property. Rather, valuation is an inexact science in the extreme. *Cf. Associates Commercial Corp.* v. *Rash*, 117 S. Ct. 1879, 1886 & n.6 (1997) (discussing various standards of valuation and various factual issues that may arise even under the replacement-value standard). One can no more "establish" the value of a real estate property through a valuation "finding" than one can "establish" the value of a share of stock by making a "finding." Markets on which stock is actively traded exist precisely because opinions about the value of companies differ — often substantially — from individual to individual, and from day to day. Like an investor willing to place his own capital at risk in reliance on a particular view of value, a bankruptcy judge can do his or her utmost to be "right," but there is no guarantee of being "right" on any given day, let alone over time. One cannot understand the real-world stakes in bankruptcy matters without recognition that even the best valuation is uncertain.

$38.5 million. Pet. App. 4a n.4, 115a. (As the Seventh Circuit explained, an undersecured creditor, unless it has affirmatively elected to the contrary, has a secured claim up to the value of the property and has an unsecured claim to the extent the debt exceeds the property's current market value. Pet. App. 3a n.1; see 11 U.S.C. §§ 506(a), 1111(b).)

Under the plan, the bank's $54.5 million secured claim is required to be paid off between seven and ten years after the original 1995 repayment date for the entire $93 million loan. Pet. App. 4a, 55a-58a. With respect to the $38.5 million deficiency claim, the bankruptcy court found that the Property would not appreciate in value during the term of the plan such that the bank would ever receive payment in full of that unsecured claim; rather, the bank would ultimately receive under the plan only about 16% of the present value of its unsecured claim. *Id.* at 28a, 133a.

In addition to ensuring that the debtor would remain in control of the Property — even though the bank's entitlement to receive $93 million in 1995 had been converted into a right to receive payments with a net present value of approximately $60 million over a seven- to ten-year period[3] — the plan of reorganization gave the debtor's pre-bankruptcy equity holders the *exclusive* right to retain their ownership interests in the debtor if they contributed new capital. The cash or cash equivalent portion of the approved new value contribution had a present value of $4.1 million, to be paid over five years. Pet. App. 4a, 24a, 34a, 111a-112a. Only the debtor's pre-petition equity holders were given the opportunity to contribute new capital in exchange for an ownership interest in the reorganized debtor. *Ibid.*; see also *id.* at 21a (recognizing exclusive nature of right of pre-petition equity holders to contribute new value in exchange for post-petition equity interests, and upholding new value exception on that basis).[4]

[3] $54.5 million + (16% of $38.5 million) = $60.66 million.

[4] Exclusivity in this context means that the *plan* did not give anyone other than old equity holders the opportunity to contribute new value for equity in return. It is not to be confused (but see Br. in Opp. 15-17), and the Seventh Circuit did not confuse it, with the defeasible exclusivity of the debtor's right to *propose a plan*. See 11 U.S.C. § 1121(b). All that anyone other than old equity holders can gain if the latter exclusivity is terminated is the right to *ask the judge* to confirm a plan other than that proposed by the debtor, which may allow someone other than old equity holders to bid on the new equity. The judge is still permitted to confirm only one plan, and that plan must still satisfy the requirements of the statute. 11 U.S.C. § 1129(c). Where the judge confirms the debtor's plan, however, the fact remains that old equity holders have been given the exclusive right to obtain new equity by contributing new value. A *confirmed plan* that, without any prior auction, gives old equity holders and only old equity holders the right to buy into the reorganized entity contravenes the plain language of Section 1129(b)(2)(B), we will argue below, because it gives old equity holders "property" "on account of" their prior, junior interest — *whether or not* the bankruptcy judge permitted someone other than the debtor to *propose* a plan, and whether or not such a plan was in fact proposed. Conflating the exclusivity of the ability to propose a plan, on the one hand, and the exclusivity of the ability to purchase interests with new value, on the other, can only confuse matters.

The purpose of the plan of reorganization and the new capital contribution was not to allow the debtor to reorganize its business to return to solvency; the bankruptcy court found that the debtor would *never* become solvent, Pet. App. 133a, and the debtor has admitted that it is "worthless in a balance sheet sense," Br. in Opp. 19.[5] Instead, the plan's principal objective was to enable the debtor's partners to retain ownership of the Property in order to postpone some $20 million in personal tax liabilities; those taxes would be due if the bank were permitted to foreclose. Pet. App. 3a, 112a-113a. The bankruptcy court found that the plan at issue "and indeed, the

[5] At the confirmation hearing on the plan, the evidence showed, and the bankruptcy court found, that the debtor would experience significant cash flow shortfalls in the seventh and eighth years of the plan. Pet. App. 107a, 153a. According to the debtor's own projections, those shortfalls would aggregate approximately $5 million in the seventh and eighth years of the plan. C.A. App. 13, 19. The plan contemplated, and the evidence showed, that the only way the debtor could compensate for the $4.5-$5 million shortfall would be if the bank voluntarily re-lent that amount from the excess cash flow payments it was expected to receive on account of its rewritten secured claim before that time. Pet. App. 153a.

entire bankruptcy case, was filed by the debtor primarily to avoid the severe tax consequences to the debtor's partners of a foreclosure sale of the debtor's property." *Id.* at 112a-113a. The debtor's partners' desire to save $20 million in taxes has thus led to confirmation of a plan that, based on the bankruptcy court's findings, will shortchange the bank by at least $32 million of the amount due in January 1995 *and* deny the bank the right to foreclose and possess the property.

The bank's secured and unsecured claims relating to its $93 million loan were placed in separate classes under the plan. Pet. App. 56a. The bank is by far the debtor's largest creditor; the other unsecured claims held by outside creditors total $90,000, less than ¼ of 1% of the bank's $38.5 million unsecured claim. *Id.* at 3a. Those outside creditors voted to accept the plan; their claims were to be paid in full, without interest, on the effective date of the plan. *Id.* at 3a-4a. The bank, however, voted its secured and unsecured claims to reject the plan. *Id.* at 114a. The bank objected to confirmation on the ground, among others, that the plan violated the absolute priority rule, because the debtor's pre-bankruptcy equity holders had the exclusive right to retain their equity interests in the debtor even though the bank's senior, unsecured claim was not satisfied in full under the plan. *Ibid.*

The bankruptcy court nonetheless confirmed the plan. The court held that, although the plan ran afoul of the absolute priority rule, that rule was limited by the new value exception, which the plan satisfied. Pet. App. 135a-140a. Based on its confirmation of the plan, the bankruptcy court denied the bank's pending motions to convert the case to a Chapter 7 liquidation or dismiss the case, and to grant the bank relief from the automatic stay that begins with the filing of a bankruptcy case, so that the bank could foreclose on the Property. J.A. 13. The district court affirmed the bankruptcy court's decisions. Pet. App. 79a-85a.

C. Proceedings In The Court Of Appeals

A divided Seventh Circuit panel affirmed. Pet. App. 11a-31a. The panel majority held, among other things, that the

absolute priority rule codified at 11 U.S.C. § 1129(b)(2)(B) is subject to a new value exception (or new value "corollary"). Pet. App. 13a-23a. The majority reasoned as follows:

- Section 1129(b)(2)(B) is ambiguous. While "[a]t some level of abstraction," prior equity holders "have the opportunity to invest and to control the company 'on account of' their previous relationship with the debtor * * * Congress, in using the 'on account of' language, might well have intended a more direct causation between the property received by the debtor and the old equity," and thus "even an exclusive right" to participate in the reorganized debtor "is not retained on account of an old equity holder's former ownership interest," but rather "on account of" a new capital contribution. Pet. App. 17a, 21a.
- In light of the perceived statutory ambiguity, the panel majority considered bankruptcy practice before the adoption of the Bankruptcy Code, and concluded that this Court "established" the new value exception in *Case* v. *Los Angeles Lumber*, and that, "for more than fifty years, the new value precept has been recognized as an important corollary or exception to the absolute priority rule." Pet. App. 14a, 19a.
- There is "no question" that Congress "'must have enacted the Code with a full understanding' of the absolute priority rule and its new value corollary." *Id.* at 20a.
- Although "Congress did not explicitly codify the new value corollary" in the Code, the "corollary" "remains a part of our bankruptcy jurisprudence" because "Congress never explicitly declared * * * that it intended the abolition" of the doctrine. *Id.* at 15a, 20a-21a, 23a.

Judge Kanne dissented. To begin with, Judge Kanne explained, "the plain language of the absolute priority rule, *see* 11 U.S.C. § 1129(b)(2)(B)(ii), does not include a new

value exception"; indeed, the statutory text "fails to even hint at" the existence of a new value exception. Pet. App. 32a, 34a. A new value exception is thus inconsistent with "the straightforward text of the statutory absolute priority rule." *Id.* at 38a.

In addition, Judge Kanne concluded that it is not reasonable to assume that Congress implicitly incorporated the new value exception into Section 1129(b)(2)(B)(ii), for two reasons. First, the new value exception rests on a "questionable foundation" under pre-Code law — the dictum in *Case*, which "no reported case expressly adopted * * * as its holding until the Code's enactment in 1978" and which has since "'taken on a life of its own in the lower courts.'" Pet. App. 41a, 42a n.5. Second, the principles underlying the new value exception "differ greatly from those under the present Bankruptcy Code." *Id.* at 42a. Because of "the massive changes in bankruptcy procedures brought on by the Bankruptcy Code," "strict adherence to the pre-Code new value exception might *contravene* Congress's intent in codifying the absolute priority rule" and, at a minimum, does not indicate "Congress's intent to *include* a new value exception in § 1129(b)(2)(B)(ii)." *Id.* at 32a, 40a-41a (second emphasis added).

Only 10 of the 11 judges of the court of appeals considered the bank's request for rehearing *en banc*. Judges Coffey, Easterbrook, Manion, Kanne, and Diane P. Wood voted to grant rehearing *en banc*, but the resultant 5-5 tie led to a denial of rehearing. Pet. App. 48a-49a.

INTRODUCTION AND SUMMARY OF ARGUMENT

Under the Bankruptcy Code, there is no new value exception to the absolute priority rule. A plan of reorganization that relies on any such exception cannot be confirmed. The plain language of the statute does not provide for a new value exception, and there is not an ounce of support for it in the legislative history. Judge Edith Jones aptly described the new value exception when, paraphrasing Gertrude Stein, she observed: "'There is no there there.'" *In re Greystone III Joint Venture*, 995 F.2d 1274, 1282, 1285 (5th Cir. 1992) (dissenting opinion).

For the debtor to prevail in this case, however, it must establish even more than the existence of a new value exception. It must establish that such an exception exists *and allows pre-petition equity holders to retain the* ***exclusive*** *right to obtain a post-petition equity interest in the estate by contributing new value*. The Seventh Circuit squarely endorsed that broad proposition, see Pet. App. 21a, as did the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899, 910-911 (1993), cert. dismissed, 513 U.S. 18 (1994). Yet, as we will show, the position of those courts is utterly impossible to square with the statutory language, which in this regard is completely unambiguous. The legislative history and considerations of bankruptcy policy, if anything, only reinforce the conclusion that is inescapable from the statutory text.

Because it would be sufficient for reversal if this Court were to accept our submission that pre-petition equity holders may not be given the exclusive opportunity to bid new value for new equity, the Court in this case is not required to address the broader argument — made by Solicitor General Fried in his *Ahlers* amicus brief and again by Solicitor General Days in his *Bonner Mall* amicus brief — that "the language and structure of the Code prohibit in all circumstances confirmation of a plan that grants the prior owners an equity interest in the reorganized debtor over the objection of a class of unpaid unsecured claims." Br. for the United States as Amicus Curiae, *Bonner Mall*, at 14.[6] Because old equity holders

[6] We concede that the argument that pre-petition equity holders enjoy their post-petition interest "on account of" their prior interests loses much of its force when an open auction is held and pre-petition equity holders prevail over all other bidders, including creditors. The separate question whether the bankruptcy court has the authority to hold such an auction, however — particularly on its own motion and not in the context of a plan that sets forth in detail the procedures that will purportedly govern any such "auction" — raises issues involving construction of a number of different provisions of the Code. Because no auction was held or proposed in this case, however, the question is not before the Court.

received the exclusive right to bid on new equity in this case, however, the Court need not reach the broader issue.

I. Section 1129(b)(2)(B)(ii) provides, in no uncertain terms, that the absolute priority rule is, in fact, to be absolute: junior classes (such as existing stockholders) are not to receive "any property" under a plan of reorganization "on account of" their pre-bankruptcy interests until senior classes of unsecured creditors are provided for in full. An option to become an owner of a business enterprise is undoubtedly "property," a term that is defined broadly in the Code. And that property is received "on account of" a prior interest when, as in this case, a plan gives pre-bankruptcy equity holders an *exclusive* opportunity to obtain a stake in the reorganized debtor — everyone except the prior equity owners is disqualified from having an opportunity to invest in the post-bankruptcy enterprise.

The broad language that Section 1129(b) uses in stating the absolute priority rule is not limited or qualified anywhere in the Code. Most importantly for purposes of this case, the Code does not contain a single reference to a new value exception. Congress listed the ways in which a plan can be crammed down on unconsenting creditors, but a new value exception is not among them.

II. Given the clarity with which Congress spoke in Section 1129(b), there is no need to turn to legislative materials. But the legislative history reinforces what is already clear from the unambiguous text of the statute: there is no new value exception. There is not a shred of support for a new value exception in the legislative history — no such exception is even mentioned, let alone endorsed — and, in fact, the committee reports and statements by floor leaders consistently described the Code's absolute priority rule as mandating that junior interests cannot receive anything at all under a plan of reorganization until senior classes of unsecured creditors are paid in full.

III. There is certainly no basis for interpreting congressional "silence" as tacit acceptance of well-settled pre-Code

law concerning a new value exception. Congress was far from silent. There was no well-settled pre-Code law of any sort on any new value question. And any new value exception that may have existed (as well as the absolute priority rule that did exist) under pre-Code law addressed circumstances wholly different from those presented today.

Notwithstanding decisions of this Court construing *ambiguous* Code provisions by reference to pre-Code law coupled with "silence" in the legislative history, it is a misunderstanding of the highest order to equate silence in the legislative history with *congressional* silence. Congress speaks through statutes; individual Members and Committees speak through legislative history. Congress spoke with more than sufficient clarity (and unquestionably changed pre-Code law in critical respects) in the *text* of Section 1129. It would flout, not further, the will of the Legislature to give that language an unnatural reading because no Member or Committee said in legislative history "we intend to change not only the pre-Code absolute priority rule, but also this particular aspect of the pre-Code absolute priority rule."

In addition, the pre-Code practice that the Seventh Circuit would have "silence" ratify rests on the shakiest of legal foundations: dicta from *Case* v. *Los Angeles Lumber* that had never been adopted as the holding of *any* reported decision before enactment of the Bankruptcy Code. It is certainly understandable that Congress would not feel any need to repudiate those dicta any more expressly than it did.

What is more, the legal landscape that prompted the suggestion of a new value exception during the Great Depression and New Deal era is fundamentally different from the law of bankruptcy that exists today. The Bankruptcy Code completely revamped the law of reorganization, creating an entirely new framework that is an amalgam of concepts derived from the various statutory schemes that preceded it. Most important among the many pertinent changes is the possibility under the Code, which did not exist under pre-Code law, of confirming a new-value (or any other) reorganization plan through the *consent* of creditors, acting as classes. In light of

the changes reflected in Chapter 11, it makes no sense to presume that Congress implicitly intended to incorporate an exception to the absolute priority rule that was proposed in the context of a vastly different bankruptcy statute.

IV. A new value exception is flatly inconsistent with the policy that is at the heart of the Bankruptcy Code: in recognition that equity is to bear the greatest risk of loss in exchange for enjoying a business's upside potential, the interests of creditors take precedence over the interests of an insolvent debtor's equity holders. The new value exception contravenes that policy by permitting an insolvent debtor's insiders — who no longer have any economic interest in the debtor's property — to grant themselves the exclusive opportunity to obtain interests in the reorganized property without having to worry about competitive bids from creditors or outsiders. This permits the debtor's insiders effectively to sell the debtor's property to themselves on their own chosen terms, checked only by a bankruptcy judge's necessarily imperfect attempt at valuation. No provision under Chapter 11 of the Bankruptcy Code permits this type of judicially sanctioned insider self-dealing, and case law under other Bankruptcy Code provisions such as Section 363 expressly condemns it. The effect of a new value exception — permitting those at the bottom of the priority ladder to control the debtor's property to the detriment of impaired creditors with a higher priority — turns the absolute priority rule on its head.

A new value exception also requires the courts to make business decisions that properly belong to the creditors. The exception permits courts to force creditors to waive the absolute priority rule, but under the Code that decision is solely for the creditors themselves to make. The Code does not give courts the power to tell senior impaired creditors that they have misperceived their own best interests.

ARGUMENT

The new value exception has been aptly described as a square peg in a round hole. Salvatore G. Gangemi & Stephen Bordanaro, *The New-Value Exception: Square Peg in a Round Hole,* 1 AM. BANKR. INST. L. REV. 173 (1993). It does not fit the language of the Code. It finds no support in the legislative history. It cannot reliably be imported from pre-Code law into the structure of the Code, which differs in crucial respects. And it contravenes fundamental bankruptcy policy.

I. THE PLAIN STATUTORY LANGUAGE DOES NOT INCLUDE A NEW VALUE EXCEPTION

The Bankruptcy Code does not contain a single reference to a new value exception. Instead, the Code simply adopts the absolute priority rule without limitation: Unless a plan of reorganization provides for payment in full to a dissenting, senior class of unsecured creditors, a plan cannot be confirmed if a junior class of unsecured creditors or equity interest holders "receive[s] or retain[s] under the plan on account of such junior claim or interest *any property*." 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added). As we explain below, that unequivocal language, combined with the absence of any textual support for an exception, compels the conclusion that the Bankruptcy Code does not contain a new value exception to the absolute priority rule.

1. The right provided to the debtor's pre-petition owners by the plan here — the exclusive opportunity to retain an equity interest in a business enterprise — certainly is "property" within the meaning of Section 1129(b). "[W]hile the Code itself does not define what 'property' means as the term is used in § 1129(b), the relevant legislative history suggests that Congress' meaning was quite broad," and included "'both tangible and intangible property.'" *Ahlers*, 485 U.S. at 208 (quoting H.R. Rep. No. 95-595, at 413 (1977)).[7]

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[7] Indeed, the Court held in *Ahlers* that an equity interest in a debtor is "property" for purposes of Section 1129(b) even if that equity interest is "worthless" and "has no value to the senior unsecured creditors." 485 U.S. at 207. The Court explained (*id.* at 207-208, quoting *Northern Pac. Ry.* v. *Boyd*, 228 U.S. 482, 508 (1913)):

> Even where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains "property." Whether the value is "present or prospective, * * *

The Second and Fourth Circuits have correctly relied on this broad definition of property in holding that "the *exclusive* right to retain the debtor's property upon making a capital contribution" is "property" within the meaning of Section 1129(b) — and that a plan including such a provision violates the absolute priority rule. *In re Coltex Loop Central Three Partners, L.P.*, 138 F.3d 39, 43 (2d Cir. 1998); *In re Bryson Properties*, 961 F.2d 496, 504 (4th Cir. 1992) (the "exclusive right to contribute [new capital] constitutes 'property' under § 1129(b)(2)(B)(ii), which was received or retained on account of a prior interest").[8] Even courts holding that a new value exception exists have agreed that the exclusive opportunity to obtain an ownership interest in an enterprise is "property" under Section 1129(b). See Pet. App. 17a; *Bonner Mall*, 2 F.3d at 910 n.27. But see Pet. App. 21a (dismissing this understanding of "property" as "highly conceptualistic"). The same type of property interest is involved here.

2. The "cardinal canon" of statutory construction is that "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992). Thus, when a statute is unambiguous, judicial inquiry begins

or only for purposes of control," a retained equity interest is a property interest to "which the creditors [are] entitled * * * before the stockholders [can] retain it for any purpose whatever."

[8] See also, *e.g.*, *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990) (Easterbrook, J.) ("[a]n option to purchase stock also is 'property'" under § 1129(b)); *In re Lumber Exchange*, 125 B.R. 1000, 1008 (Bankr. D. Minn.) ("A special opportunity or right afforded to members of a class of equity security holders to retain or acquire an equity position in a reorganized debtor through a new cash contribution under a plan is, by its very nature, the opportunity or right to receive or retain property on account of the prepetition interest held."), aff'd, 134 B.R. 354 (D. Minn. 1991), aff'd, 968 F.2d 647 (8th Cir. 1992); BAIRD, *supra*, at 261 ("The right to get an equity interest for its fair market value is 'property' as the word is ordinarily used. Options to acquire an interest in a firm, even at its market value, trade for a positive price. They are bought and sold every day.").

and ends with "the words of [the] statute." *Id.* at 254. In a case involving interpretation of the Bankruptcy Code, no less than any other statute, when "the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *United States* v. *Ron Pair Enterprises*, 489 U.S. 235, 241 (1989) (quoting *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917)).

The statute at issue here is unambiguous. Section 1129(b)(2)(B)(ii) states that a plan that does not provide a dissenting class of unsecured creditors with property of a value, as of the effective date of the plan, equal to the amount of their claims *cannot* be confirmed unless "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest *any property*." (Emphasis added.) The language is unequivocal; it does not allow a junior class to receive "any" property "on account of" its pre-petition interest unless senior classes are provided for in full.

This Court has regularly construed broadly written Bankruptcy Code provisions expansively, in accordance with their plain meaning.[9] That approach should be followed here as well. The Court must presume that Congress expressed its intent in stating, in the broadest conceivable terms, that junior classes were barred from receiving "any" property because of their pre-bankruptcy interests in the debtor unless senior creditors are provided for in full. Even if it were doubtful that Congress had the new value exception in mind when it wrote such a broad prohibition, that would not matter. "As we

[9] See *Patterson* v. *Shumate*, 504 U.S. 753, 757-758 (1992) (statutory phrase "applicable nonbankruptcy law" encompasses state and federal law); *Union Bank* v. *Wolas*, 502 U.S. 151, 154-156 (1991) ("debt" includes long-term and short-term debt); *Toibb* v. *Radloff*, 501 U.S. 157, 160-161 (1991) (Code provision allowing a "person" to file a Chapter 11 proceeding includes nonbusiness individual debtors); *Pennsylvania Dep't of Public Welfare* v. *Davenport*, 495 U.S. 552, 557-560 (1990) ("debt" includes restitution orders); *Ron Pair*, 489 U.S. at 241-242 ("[r]ecovery of postpetition interest is unqualified" in § 506 of the Code, and thus Congress did not distinguish between consensual and nonconsensual liens).

have said before, the fact that a statute can be '"applied in situations not expressly anticipated by Congress does not demonstrate ambiguity. It demonstrates breadth."'" *Pennsylvania Dep't of Corrections* v. *Yeskey*, 66 U.S.L.W. 4481, 4483 (U.S. June 15, 1998).

Nor is there the slightest indication in the statute that the sweeping prohibition on the receipt of "any" property by junior classes is qualified by any type of exception or limitation, much less a new value exception. As even Judge Reinhardt, writing for the court, conceded in *Bonner Mall*, "a textual search for a 'new value exception' to the absolute priority rule dictates its own negative result because such a statutory exception *does not exist*." 2 F.3d at 909 n.25 (emphasis added). That should be the end of the matter. The Bankruptcy Code simply does not contain a new value exception — and this Court should not add statutory provisions that Congress did not enact. See *Bates* v. *United States*, 118 S. Ct. 285, 290 (1997) ("we ordinarily resist reading words or elements into a statute that do not appear on its face"); *62 Cases* v. *United States*, 340 U.S. 593, 596 (1951) (Frankfurter, J.) ("Congress expresses its purpose by words. It is for us to ascertain — neither to add nor to subtract, neither to delete nor to distort.").[10]

3. The court below, and other supporters of a new value exception, have attempted to find ambiguity in the statutory language through two devices. The first is the purest

[10] Section 1129(b) provides that the condition that a plan be "fair and equitable * * * *includes* the following *requirements*" (emphasis added). One of the requirements that follows is the absolute priority rule. The word "includes" does not leave room for a new value exception. The "requirements" set forth in Section 1129(b) are the *minimum* prerequisites that must be satisfied before a court may confirm a plan of reorganization. See *In re D&F Constr., Inc.*, 865 F.2d 673, 675 (5th Cir. 1989). The "includes" provision thus permits a court to impose *additional* requirements, but it is not a license to *dilute* requirements that Congress expressly set forth in the statute. "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Ahlers*, 485 U.S. at 206.

bootstrapping: because courts and commentators have differed about whether the new value exception exists, there *must* be ambiguity. See, *e.g.*, Pet. App. 18a-19a. But that one-way ratchet, which renders the Bankruptcy Code more and more ambiguous whenever courts purport to find ambiguity in it leading to different constructions, is the path to interpretive chaos — not just in this case, but in every case involving an issue of even the slightest difficulty under the Code. Moreover, this approach cannot be reconciled with this Court's decisions. In *Ron Pair*, for example, the majority held that the Code provision at issue was unambiguous even though four Justices thought that the better construction was the one rejected by the majority. As Judge Kanne rightly pointed out, *all* of this Court's bankruptcy decisions "command courts to apply a statute's unambiguous language without looking beyond it." Pet. App. 38a.

The second argument often advanced to try to fit the new value exception within a statute that does not "even refer to[ ] the new value exception," *Bonner Mall*, 2 F.3d at 909, is that the equity holders' post-petition interest is not received or retained "on account of" their pre-petition interest but rather "on account of" the new value they contribute. See, *e.g.*, Pet. App. 17a, 21a. New value proponents acknowledge that, "[a]t some level of abstraction, the new investors in the plan can be said to have the opportunity to invest and to control the company 'on account of' their previous relationship with the debtor." *Id.* at 17a; see also *Bonner Mall*, 2 F.3d at 909 ("in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners"). But they contend that a "more direct" reason for the retained equity interest is the contribution of new value. Pet. App. 17a. This argument suffers from two flaws.

First, it ignores the text of the statute, which instructs courts to determine whether "any property" is received "on account of" a junior interest. Backers of a new value exception shift the focus from the property interest at issue — the exclusive opportunity to obtain an equity stake in the reorganized debtor — to the ownership interest ultimately purchased

as a result of exercising that property right. But when the interpretive focus is *not* on the purchased equity interest, but instead, as the statute requires, is on the property interest provided by the plan (the *exclusive right* to share in ownership of the debtor), the conclusion is inescapable that the pre-bankruptcy equity holders are receiving property "on account of" their pre-bankruptcy interests.

The Seventh Circuit's response to this point was to belittle as "highly conceptualistic" the "suggestion that the opportunity to participate in the reorganization is itself property retained on account of an old equity holder's prior ownership interest." Pet. App. 21a. Conceptualistic or not, however, that is no mere suggestion: it is the square *holding* of this Court in *Ahlers*, 485 U.S. at 207-209, construing the term "property" in the very statute at issue here. The Seventh Circuit was not at liberty to depart from this Court's unanimous *Ahlers* decision by redefining "property" in a way it regarded as less "conceptualistic." Moreover, it is the Seventh Circuit that has sacrificed the practical to the conceptual by attempting to discern "a more direct causation" that "Congress * * * might well have intended." Pet. App. 17a. The very essence of any policy argument in favor of a new value exception (other than naked pro-debtor sympathy) is that, *as a practical matter*, old equity holders *as such* must be given the opportunity to participate in a reorganization by contributing new value.[11] Whatever one thinks of that argument as a policy matter, it is simply disingenuous to pretend that old equity holders are not getting special treatment "on account of" their old equity interests.

The Seventh Circuit's related statement that, "[a]s a practical matter, the opportunity to participate in a reorganization plan, even an exclusive right, is not retained on account of an old equity holder's prior ownership interest," Pet. App. 21a,

[11] See, *e.g.*, Charles W. Adams, *New Capital for Bankruptcy Reorganizations: It's the Amount that Counts*, 89 NW. U.L. REV. 411, 426 (1995) ("the Court should recognize the exception, because an insolvent corporation's former owners are often the only feasible source of new capital, and their contributions should be encouraged, rather than barred").

is mere *ipse dixit*. And it is *ipse dixit* with an Alice-in-Wonderland quality at that, considering that the Seventh Circuit in the very same paragraph asserted that "exclusivity may be necessary simply because it may be easier to obtain additional funding from the old equity participants." *Ibid.* One cannot, with any intellectual coherence, simultaneously praise special treatment for old equity holders as a policy matter and deny that such special treatment renders the participation "on account of" old equity holders' status as such. See Michael H. Strub, Jr., *Competition, Bargaining, and Exclusivity Under the New Value Rule: Applying the Single-Asset Paradigm of Bonner Mall*, 111 BANKING L.J. 228 (1994); see also Miller, *supra*, 77 B.U. L. REV. at 1008-1009 ("This preference, this blatant diversion of property and benefits by shareholders to shareholders, arises only on account of their shareholder status in the corporation before reorganization.").

Second, the "on account of" argument mistakenly assumes that there is an inconsistency between occurring "on account of" one thing and *also* occurring "on account of" something else. For example, Justices sit on this Court "on account of" *both* appointment by the President and confirmation by the Senate. To assert that they do not enjoy their positions "on account of" appointment by the President, just because senatorial confirmation is also necessary, would be absurd. It is equally meaningless to say that a Justice sits on this Court "primarily" because of either appointment by the President or confirmation by the Senate. When an event has two absolute prerequisites, labeling one or the other as "primary" cannot possibly aid analysis.

To take another example, mixed motives are quite familiar in the law of employment discrimination. See, *e.g.*, *Price Waterhouse* v. *Hopkins*, 490 U.S. 228 (1989). Cases where an employer took adverse action "because of * * * sex" and also for more legitimate reasons present many vexing questions, but no one would be so bold as to claim that the illicit motivation can be *completely ignored* just because the adverse action was also taken "because of" something else. See *ibid.*; see also *Oncale* v. *Sundowner Offshore Services, Inc.*, 118

S. Ct. 998, 1003 (1998) (Thomas, J., concurring) ("the Court stresses that in every sexual harassment case, the plaintiff must plead and ultimately prove Title VII's statutory requirement that there be discrimination 'because of . . . sex.'"); *McKennon* v. *Nashville Banner Co.*, 513 U.S. 352, 360 (1995) ("[m]ixed-motive cases" are apposite "to the important extent [that] they underscore the necessity of determining the employer's motives in ordering the discharge"). So too in this case. The equity holders enjoy their post-petition interest under the plan "on account of" *both* their prior equity positions and their promise to contribute new value.

This violates the plain language of the absolute priority rule. It does not matter that there are two reasons why a prior equity holder is able to retain an ownership interest in the post-bankruptcy enterprise. The statute does not require a court to determine (nor could a court rationally determine) "whether a reorganization plan that gives stock to former equity holders does so *primarily* * * * 'on account of' old equity's prior ownership or 'on account of' its new contribution." *Bonner Mall*, 2 F.3d at 909 (emphasis added). As Judge Kanne explained, for that type of inquiry to be warranted by Section 1129(b), one would have to insert into the statute "the words 'solely or primarily' before 'on account of.'" Pet. App. 36a. And "[f]or the court to add such modifiers would work a significant and unwarranted change in the meaning and consequence of the statute." *Coltex*, 138 F.3d at 43. Thus, a plan violates Section 1129(b) if *one* reason a pre-petition equity holder obtains an ownership stake in the debtor is "on account of" the prior interest, which it unquestionably is when old equity holders' right is exclusive.[12]

[12] This straightforward reading of Section 1129(b)(2)(B)(ii) does not prevent pre-petition equity holders from ever receiving or retaining a post-bankruptcy interest in a debtor and thus, contrary to Judge Reinhardt's claim in *Bonner Mall*, 2 F.3d at 909, does not render the "on account of" language "superfluous." "If prior equity holders earn their shares in an open auction, for example, their reserved interests would not be 'on account of' their junior interests but on account of their capital contributions." Pet. App. 36a (Kanne, J., dissenting). In addition, creditors are free to consent, as they often do (and did, then to no avail, in *Case*), to plans that allow prior equity owners to retain an interest in the post-bankruptcy debtor. See *id.* at 47a n.7 and cases cited there. An equity interest holder also may hold senior claims against the debtor and might receive equity interests in the reorganized debtor under the plan "on account of" those senior claims and thus, not "on account of" its equity interests.

In these circumstances, the debtor's pre-petition equity holders are receiving a property right not available to anyone else, and they are getting that *exclusive* opportunity *solely* "on account of" their prior equity interests in the debtor — that is the distinguishing characteristic that entitles them to preferential treatment. In this case, for example, prior equity holders are the *only* persons permitted under the plan to make such an investment; other persons are barred from doing so, no matter how much capital they might be willing to invest in the post-petition debtor. And the debtor's partners

> receive this *exclusive* ownership right *only* "on account of" their unique status as prior equity holders. The Plan's grant of this *exclusive* right to [the debtor's] partners thus provides a *necessary* element that causes the prior equity holders to retain their junior interests before the satisfaction of Bank America's deficiency claim.

Pet. App. 34a (Kanne, J., dissenting); see also *Coltex*, 138 F.3d at 44 ("the Partners could not have gained their new position but for their prior equity position"); *Greystone*, 995 F.2d at 1283, 1285 (Jones, J., dissenting) ("Greystone intends to prevent creditors from acceding to ownership of the property on account of Greystone's unique status as an old equity contributor to the plan").[13]

[13] Judge Kanne noted that "[t]he motivations of [the debtor's] partners magnify this point." Pet. App. 34a. The only reason they contributed new capital was to postpone $20 million in individual tax liabilities that would be assessed if the bank were permitted to foreclose. In other words, "the presence of (and the potential tax liability inherent in) the partners' prior equity interests motivated the Plan's inclusion of the partners' exclusive right to retain their equity interests." *Id.* at 35a.

4. In finding the statute ambiguous, the panel majority relied in part on the notion that past bankruptcy practice cannot be disregarded "absent a clear indication that Congress intended to break from those practices." Pet. App. 20a. As discussed at pp. 26-32, 33-36, *infra*, the majority's premise is faulty. There was no settled pre-Code practice holding that new value plans were permissible, and, in fact, the legislative history indicates that Congress intended the absolute priority rule to be *absolute*.

But while all of that provides further support that Section 1129(b)(2)(B)(ii) means what it says, it is unnecessary to consider either the legislative history or the pre-Code practice. "[T]he clarity of the statutory language at issue in this case obviates the need for any such inquiry." *Patterson*, 504 U.S. at 761. Indeed, this Court has stressed that the unambiguous words of the Bankruptcy Code must be applied even when the statute changes established pre-Code practice. See *Dewsnup* v. *Timm*, 502 U.S. 410, 419-420 (1992) ("Of course, where the language is unambiguous, silence in the legislative history cannot be controlling."); *Toibb*, 501 U.S. at 162 (there is "no need" to examine legislative history unless "'the statutory language is unclear'") (quoting *Blum* v. *Stenson*, 465 U.S. 886, 896 (1984)); *Davenport*, 495 U.S. at 563-564 (1990) (enforcing plain meaning of Bankruptcy Code provision even though it abrogated pre-Code practice).

All of this accords with settled principles. "[L]egislative history need not confirm the details of changes in the law effected by statutory language before we will interpret that language according to its natural meaning." *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 385 n.2 (1992); see also, *e.g.*, *Toibb*, 501 U.S. at 164 (because of "the plain language of the statute," it "makes no difference whether the legislative history affirmatively reflects [congressional] intent"); *Yeskey*, 66 U.S.L.W. at 4483 (even if Congress did not envision a particular application of a statute, "in the context of an unambiguous statutory text that is irrelevant"); *Bourjaily* v. *United States*, 483 U.S. 171, 178 (1987) ("[i]t would be extraordinary to require legislative history to *confirm* the plain

meaning of [a federal statute]," even when Congress has changed existing law); *Almendarez-Torres* v. *United States*, 118 S. Ct. 1219, 1241 n.6 (1998) (Scalia, J., joined by Stevens, Souter & Ginsburg, JJ., dissenting) (quoting *Morales*). That principle is particularly important here because the Bankruptcy Code, nearly a decade in the making, effected "such a substantial overhaul of the system." *Ron Pair*, 489 U.S. at 240. Under the circumstances,

> it is not appropriate or realistic to expect Congress to have explained with particularity each step it took. Rather, as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute.

Id. at 240-241.[14]

* * *

Had Congress wanted to include a new value exception in the Bankruptcy Code, it could have done so easily. It did not. See Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 536 (1947) (in interpreting a statute, "[o]ne must * * * listen attentively to what it does *not* say") (emphasis added). Courts "must enforce the statute according to its terms," *Patterson*, 504 U.S. at 759, and by its terms, the Bankruptcy Code simply does not include a new value exception to the absolute priority rule — certainly not one broad enough to allow the pre-petition

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[14] Having made no mention of any new value exception in the statute, Congress, of course, provided no guidance as to the content of any such exception. Any such development, therefore, must occur entirely in the courts. But Congress knows how to say when it intends such judicial development of the content of a Bankruptcy Code provision. See, *e.g.*, 124 Cong. Rec. 32,398 (1978) ("It is intended that the term 'principles of equitable subordination' [in 11 U.S.C. § 510(c)] follow existing case law and leave to the courts development of this principle.") (statement of Rep. Edwards); *id.* at 33,998 (same) (statement of Sen. DeConcini). That Congress did not do so here reinforces the conclusion that it intended the codified absolute priority rule to be enforced as written, not to be subject to an exception — uncodified and unmentioned in the legislative history — to be developed by the courts.

equity holders to enjoy the exclusive right to contribute new value that they were accorded here.

II. THE LEGISLATIVE HISTORY SHOWS THAT CONGRESS DID NOT PROVIDE FOR A NEW VALUE EXCEPTION TO THE ABSOLUTE PRIORITY RULE

"Given the clarity of the statutory text, respondent's burden of persuading [the Court] that Congress intended to create *or to preserve* a special rule" in accordance with supposed pre-Code practice "is *exceptionally heavy*." *Wolas*, 502 U.S. at 155-156 (emphasis added). A statute's "plain meaning" is ordinarily "conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" *Ron Pair*, 489 U.S. at 242 (quoting *Griffin* v. *Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)). This is not one of those rare cases. There is no "'clearly expressed legislative inten[t] * * * contrary' to the plain language" of Section 1129(b)(2)(B)(ii). *Toibb*, 501 U.S. at 162 (quoting *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). The legislative history, in fact, reinforces the clear import of the statutory text: there is no new value exception to the absolute priority rule.

1. Before enactment of the Bankruptcy Code, bankruptcy proceedings were governed by the Bankruptcy Act of 1898, which contained three rehabilitative chapters, Chapters X, XI, and XII. See generally Pet. App. 42a-43a (Kanne, J., dissenting). Each chapter differed from the others with respect to the standards that had to be met to confirm a plan over a dissenting class of unsecured claims. Chapter X (and its predecessor, Section 77B) authorized a court to approve a plan only if it was "fair and equitable," but the statute did not define that phrase. *Case*, 308 U.S. at 114-115. Chapter X, as construed by the Court, also imposed the "fair and equitable" requirement even in cases of creditor consent: "where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by § 77B, sub. f for confirmation of the plan has consented." 308 U.S. at 114. It was against this backdrop, in the course of elucidating the meaning of the "fair and equitable" requirement, that Justice Douglas suggested that there might be a judicially created exception to the absolute priority rule. *Id.* at 114-121.

Two other business rehabilitative chapters also existed before adoption of the Bankruptcy Code. Under Chapter XI, as amended in 1952, there was no "fair and equitable" requirement; thus, the absolute priority rule did not apply in Chapter XI proceedings, and "cases under that chapter did not address any new value issues." Pet. App. 43a n.6 (Kanne, J., dissenting). Chapter XII, which dealt with real estate reorganizations, also "did not require that a plan conform to the absolute priority rule" after the statute was amended in 1952, and thus new value issues never arose under Chapter XII either. Gangemi & Bordanaro, *supra*, 1 AM. BANKR. INST. L. REV. at 188 & n.106.

2. In 1973, five years before adopting the Code, Congress considered comprehensive bankruptcy legislation that, among other things, proposed "modify[ing] the absolute priority rule to permit equity holders to participate in a reorganized enterprise based on their contribution of 'continued management * * * essential to the business' or other participation beyond 'money or money's worth.'" *Ahlers*, 485 U.S. at 205 (quoting H.R. Doc. No. 93-137, pt. 1, at 258-259 (1973)). This proposal "prompted adverse reactions from numerous sources," and Congress rejected it. *Ibid.*; see also J. Ronald Trost & Lawrence P. King, *Congress and Bankruptcy Reform Circa 1977*, 33 BUS. LAW. 489, 553-556 (1978).

Some opinions view this as congressional repudiation of a new value exception. *E.g.*, *Kham & Nate's Shoes*, 908 F.2d at 1361-1362. Others interpret these events as endorsement of what they incorrectly perceive to have been the status quo, including the dicta in *Case*. *E.g.*, *In re Snyder*, 967 F.2d 1126, 1130 (7th Cir. 1992).[15] All of this is speculation; the legisla-

[15] Of course, it is indisputable that Congress changed the absolute priority rule itself — by making it apply only in the absence of creditor *con-*

tive materials give no indication *why* Congress rejected the 1973 legislation. As a result, this earlier proposal sheds little light on the question presented in this case.

3. The legislative history of the statute actually enacted in 1978 is much more revealing. To begin with, in discussing then-current law, Congress described the absolute priority rule, as applied under Chapter X of the Bankruptcy Act of 1898, as a rigid requirement and did not even suggest the existence of a new value exception, much less congressional acceptance of such an exception. In fact, there is not a single reference to a new value exception to the absolute priority rule in either the House Report or the Senate Report, S. Rep. No. 95-989 (1978). Rather, the House Report summarized the law under Chapter X as follows:

> Chapter X requires application of the absolute priority rule as a standard for confirmation of a plan. Under that rule, senior creditors *must be paid in full* under the plan *before* junior creditors or *stockholders may receive anything*.

H.R. Rep. No. 95-595, at 222 (emphasis added).[16]

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sent — in 1978. That change is so radical that it would have required a ruling *against the objecting creditors* in *Case*, which was decided in those creditors' favor. See BAIRD, *supra*, at 262. It is unclear how anyone could think that the "status quo" supposedly ratified by congressional inaction included an exception to a rule that did not exist in its present form until 1978. See Miller, *supra*, 77 B.U. L. REV. at 1012-1013 ("Congress clearly and explicitly revolutionized bankruptcy law by opening the door to shareholder participation over the objection of dissenting creditors who were part of accepting classes, thereby preventing one or two dissatisfied creditors from foiling a feasible reorganization plan.") (footnote omitted).

[16] Similarly, neither Representative Don Edwards nor Senator Dennis DeConcini — the managers of the legislation, see *Ron Pair*, 489 U.S. at 243 n.6 — mentioned a new value exception at all in their statements about the bill. See 124 Cong. Rec. 34,128 (1978); *id.* at 33,990-34,019; *id.* at 32,350-32,420; *id.* at 28,257-28,284; *id.* at 1799; 123 Cong. Rec. 36,095 (1977); *id.* at 35,642-35,693; *id.* at 35,444-35,457.

Congressional statements about the legislation that ultimately became the Bankruptcy Code also indicate that Congress intended to adopt an absolute priority rule that did not include any exceptions. It replaced the court-centered Chapter X, which required application of the absolute priority rule even when all classes of creditors had consented to a plan, with a party-centered Code providing creditors and debtors with substantially more autonomy. The cramdown provisions, making a court resolve the parties' differences, were a substantially less favored alternative than consented-to plans.[17] This was wholly intentional and was arguably the centerpiece of the entire reorganization reform that took place in 1978:

> The premise of the bill's financial standard for confirmation is the same as the premise of the securities law: *parties should be given adequate disclosure of relevant information, and they should make their own decision on the acceptability of the proposed plan of reorganization*. The bill does not impose a rigid financial rule for the plan. The parties are left to their own to negotiate a fair settlement. The question of whether creditors are entitled to the going-concern or liquidation value of the business is impossible to answer. It is unrealistic to assume that the bill could or even should attempt to answer that question. *Instead, negotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders*. The bill only sets the outer limits on the outcome: it must be somewhere between the going-concern value and the liquidation value.
>
> *Only when the parties are unable to agree on a proper distribution of the value of the company does the bill*

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[17] In this respect, the Bankruptcy Code stemmed from the same policies of increased reliance on negotiation and market forces, and decreased reliance on courts and regulators, that underlay the entire (and wildly successful) movement of deregulatory reform in the 1970s. See generally STEPHEN G. BREYER, REGULATION AND ITS REFORM (1982); ALFRED E. KAHN, THE ECONOMICS OF REGULATION xv-xxxvii (2d ed. 1988) (Introduction: A Postscript, Seventeen Years After).

> *establish a financial standard.* * * * * The rule is a ***partial application*** of the absolute priority rule now applied under chapter X and requires a full valuation of the debtor as the absolute priority rule does under current law. The important difference is that the bill *permits* senior classes [*i.e.*, by consent] to take less than full payment, in order to expedite or insure the success of the reorganization.

H.R. Rep. No. 95-595, at 224 (emphasis added and footnotes omitted).

This legislative history powerfully supports the proposition that the Code provides a way for new-value plans to succeed that pre-Code law did not. But the mechanism the Code provides for such plans is *not* the one postulated by the court below: cramdown of such a plan on unconsenting creditors. Rather, consistent with the overall thrust of the Code, shareholders must persuade creditors to *consent* to a new-value plan, or the plan must honor the absolute priority rule.[18] There is no third alternative.

The House Report further elaborated with a straightforward statement of the absolute priority rule, with no mention of an exception:

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[18] As Professor Miller has written (77 B.U. L. REV. at 1009-1010):

> Negotiation between creditors and the debtor is the hallmark of Chapter 11. Under consent receivership and the Act, the absolute priority rule reigned supreme: a creditor could not waive application of the absolute priority rule even if that creditor wanted to. New value represented the only legitimate avenue for shareholder participation in the reorganization of an insolvent debtor. By comparison, under the Code, the absolute priority rule does not apply where all classes of creditors and shareholders accept the plan. Thus, the Code not only allows, but encourages, shareholder participation with or without a new value contribution. * * * This ability to agree on a means for raising capital vitiates the need for the new value exception as announced in *Case*. * * * Because the absolute priority rule vanishes with the creditors' agreement, the new value exception drops out as dysfunctional and irrelevant. [Footnotes omitted.]

> If [the dissenting impaired class] is paid in full, then junior classes may share. * * * [I]f the class is impaired, then they must be paid in full or, if paid less than in full, then *no class junior may receive anything* under the plan. This codifies the absolute priority rule from the dissenting class on down.

H.R. Rep. No. 95-595, at 413 (emphasis added); see also *id.* at 416 (when a dissenting, impaired class of unsecured creditors receives less than full value under the plan, the plan may be confirmed "if junior classes will receive *nothing* under the plan") (emphasis added); *Kham & Nate's Shoes*, 908 F.2d at 1362 ("[n]either the [House] report nor any part of the text of the Code suggests a single exception" to the "blanket rule" of absolute priority).

The statements made by the bill's floor leaders, when presenting the legislation for final approval after a conference committee agreed on the final text of the bill, provide further evidence that Congress intended to adopt an *absolute* priority rule, one that did not contain any exceptions. Representative Edwards told the House that a plan could be confirmed over the objections of a dissenting class of impaired unsecured creditors "as long as no class junior to the dissenting class receives *anything at all*." 124 Cong. Rec. 32,408 (1978) (emphasis added). Senator DeConcini made the same statement to his colleagues. *Id.* at 34,007.[19]

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[19] In addition, Representative Edwards and Senator DeConcini each noted that, "[a]lthough many of the factors interpreting 'fair and equitable' are specified in paragraph (2)" of Section 1129(b), "others, which were explicated in the description of section 1129(b) in the House report, were omitted" from the final bill "to avoid statutory complexity and because they would undoubtedly be found by a court to be fundamental to 'fair and equitable' treatment of a dissenting class," such as the requirement that no senior class receive more than 100% of the amount of its claims. 124 Cong. Rec. 32,407 (1978); *id.* at 34,006. A new value exception was not one of the other factors "explicated * * * in the House report"; the Report does not even mention a new value exception in its description of Section 1129(b). See H.R. Rep. No. 95-595, at 413-418. Rather, as noted in the text, the Report states consistently that a plan cannot be confirmed when a senior class has not been provided for in full unless junior classes

* * *

The legislative history shows that Congress intended to codify the absolute priority rule without a new value exception. Even if it did not do so, however, application of the plain language of Section 1129(b) would still be warranted given the complete absence of *any* reference to, let alone *affirmative* support for, a new value exception in the Code's legislative history. This void in the legislative history distinguishes this case from *Dewsnup*, where there was legislative history indicating specifically that Congress intended the pre-Code practice to survive. 502 U.S. at 419. When the statutory text gives no indication that Congress intended to codify pre-Code law and the legislative history "does not even mention" the pre-Code practice, the Court must enforce the plain language of the statute. *Wolas*, 502 U.S. at 159 & n.14 (1991). As we have already explained, Section 1129(b) by its terms does not, expressly or by any implication, provide for a new value exception.

III. CONGRESS DID NOT ADOPT THE NEW VALUE EXCEPTION *SUB SILENTIO* WHEN IT ENACTED THE BANKRUPTCY CODE IN 1978

The panel majority's decision rested on its belief that this Court "established" the new value exception in 1939, and that, when Congress enacted the Bankruptcy Code nearly 40 years later, it "must have" done so with a "full understanding" of this doctrine, which the majority thought "has long been ensconced in our bankruptcy practice." Pet. App. 14a, 20a. Those assumptions are patently incorrect. Furthermore, in light of the vast differences between the Code and the law of bankruptcy in 1939, there is no basis for postulating that Congress implicitly meant to include a new value exception for reorganization proceedings under the Code.

"receive *nothing* under the plan." *Id.* at 416 (emphasis added).

A. A New Value Exception Was Not An Established Part Of Bankruptcy Practice In 1978

1. This Court has never "established" a new value exception. Pet. App. 14a. On the contrary, the new value exception is rooted only in dicta found in Justice Douglas's opinion for the Court in *Case*, 308 U.S. at 121-122.[20] See also *Ahlers*, 485 U.S. at 203. But the Court has never adopted those dicta to uphold the confirmation of any plan based on a new value exception; as Judge Easterbrook has noted, "[s]o far as the Supreme Court is concerned," the development of the new value exception "has been 100% dicta." *Kham & Nate's Shoes*, 908 F.2d at 1360.[21]

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[20] For historical perspective on *Case*, and in particular for Justice Douglas's view that the Court's ruling *in favor of the creditors* in that case struck a blow against the "reorganization racket[ ]," see Philip E. Urofsky (ed.), *The Diary of Wm. O. Douglas*, 1995 Y.B. SUP. CT. HIST. SOC'Y 80, 84-85. Justice Douglas's diary indicates that he was responsible for persuading his Brethren to grant the creditors' certiorari petition as well as writing the opinion of the Court.

[21] The Court repeated the *Case* dicta in *Mason* v. *Paradise Irrigation Dist.*, 326 U.S. 536, 541-542 (1946), cited by the panel majority (Pet. App. 20a n.9), but *Mason* involved purported discrimination among creditors in the *same* class, not whether a plan that permits junior interests to retain interests regardless of the treatment of more senior claims is fair and equitable. Thus, *Mason* simply does not address whether a prior equity holder may retain an ownership interest in the debtor due to a contribution of new capital, when senior creditors are not paid in full. In fact, the new funding in *Mason* was provided to the debtor in the form of a loan by a *creditor*, the Reconstruction Finance Corporation, not an equity holder. And under the plan of reorganization, the RFC did not acquire an equity interest in the debtor, a local governmental unit in California.

The panel majority also cited (Pet. App. 20a n.9) *Marine Harbor Properties* v. *Manufacturer's Trust Co.*, 317 U.S. 78 (1942), but that case is inapposite as well. *Marine Harbor* involved the dismissal of a Chapter X petition and *not* the attempted confirmation of a plan over the objection of a dissenting class of unsecured claims based on the new value exception; even in that context, the Court quoted the *Case* dicta, but noted that there was "no suggestion in the record that the equity owners desire[d] to make a contribution on that basis." *Id.* at 85-86.

Moreover, it is generally understood that the *Case* dicta themselves rely on "a misunderstanding of earlier law." BAIRD, *supra*, at 263; see also, *e.g.*, John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963, 999-1007 (1989); DAVID G. EPSTEIN, STEVE H. NICKLES, & JAMES J. WHITE, BANKRUPTCY 841-843 (1993). The *Case* dicta, 308 U.S. at 121-122, are based on *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U.S. 445 (1926), but the two cases were decided in much different contexts. *Kansas City Terminal* was a case in which the senior creditor was owed more than the value of the debtor's assets and had *consented* to keeping the old stockholders in place, while freezing out intermediate creditors. *Case*, in contrast, involved a situation in which senior creditors were *objecting* to providing the prior equity holders with a continued interest in the business. Furthermore, *Case* "did not remark on the difference between consent and objection from the creditors," even though its dicta constituted "a dramatic step" from *Kansas City Terminal*. *Kham & Nate's Shoes*, 908 F.2d at 1361; see also Pet. App. 41a (Kanne, J., dissenting). For these reasons, "*Kansas City* offers *no* support for the proposition that the shareholders have a right to stay on board independent of the wishes of any creditor." BAIRD, *supra*, at 262.

2. It is also not true that a new value exception had "long been ensconced" in bankruptcy practice in the lower courts before 1978. Pet. App. 20a. In fact, as the Second Circuit and Judge Kanne have noted (*Coltex*, 138 F.3d at 44; Pet. App. 42a n.5), under Chapter X of the prior statute "*no* reported case seems to have adopted Justice Douglas' dicta as its holding" before 1978. Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 92 (1991) (emphasis added). As one commentator summarized,

> There appears to be no reported case in the entire period in which the court expressly permitted the "debtor," or former equity owners, to retain assets on the strength of a new value contribution and for no other reason. * * * Justice Douglas' supposed "exception" * * * is nowhere present as a rule of decision in Chapter X cases. New value under Chapter X, then, is an illusion.

Ayer, *supra*, 87 MICH. L. REV. at 1016. In addition, Chapter X — the only pre-Code business reorganization Chapter that required adherence to the absolute priority rule — had fallen into disuse; the 1977 House Report stated that "[l]ess than ten percent of all business reorganization cases are under chapter X." H.R. Rep. No. 95-595, at 222. In short, at the time Congress enacted the Bankruptcy Code, the *Case* dicta were "seemingly moribund." 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c], at 1129-108 (L. King. 15th ed. rev. 1997).[22]

3. Given the absence of any reported decision before 1978 purporting to apply the exception, the panel majority's statement that "the new value exception traditionally has played" a "major role * * * in the bankruptcy field," Pet. App. 20a, is dubious at best. And this Court has held that when a purported pre-Code "practice" is of "doubtful provenance," it is "certainly not the type of 'rule' that we assume Congress was aware of when enacting the Code." *Ron Pair*, 489 U.S. at 246; see also *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 380-381 (1988) (rejecting the argument that Congress intended to preserve pre-Code law, which supposedly gave undersecured creditors an entitlement to foreclose, because "it is far from clear that there was a distinctive Chapter XI rule of absolute entitlement to foreclosure").

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[22] Since *Ahlers*, very few new value plans have actually been confirmed, but the vast majority of those that have been confirmed — including the plan in the present case — have been confirmed very recently. See J. Ronald Trost, et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595, 619 & n.77, 644 & n.174 (1997) (available on Westlaw). Thus, ironically, the Bankruptcy Code, whose language and structure are far more inhospitable to any new value exception than pre-Code law, is being construed to allow the holders of old equity in insolvent enterprises *greater* practical opportunities to buy into a reorganized business over creditors' objections than the prior law.

Ron Pair, for example, involved pre-Code cases that had denied post-petition interest to the holders of nonconsensual liens; the "rule" at issue had been "recognized by only a few courts," and there was "some uncertainty" among them "whether this Court had ever done so." 489 U.S. at 246. The Court held that the "rule" supposedly found in those cases was not such a "well-established judicially created rule" that the Court could presume that Congress was aware of it, and implicitly approved it, when adopting the Code. *Id.* at 246-247. Similarly, in *Timbers*, the Court noted that the posited pre-Code "rule" was supported only by "dicta in some Chapter XI cases" and said that "[t]he at best divided authority under Chapter XI removes all cause for wonder that the alleged departure from it should not have been commented upon in the legislative history." 484 U.S. at 381-382.

The new value exception has an even more "doubtful provenance," *Ron Pair*, 489 U.S. at 246, under pre-Code law. The exception is based on dicta that, when the Code was enacted, were nearly 40 years old, had never been the basis for a decision of this Court upholding confirmation of a plan, and had not been relied on for the holding in any reported lower court decisions. It is hardly surprising that the legislative history does not explain why Congress enacted the absolute priority rule without a new value exception.

Because the new value exception was far from being well recognized in 1978, there is no basis for concluding that "Congress must have enacted the Code with a full understanding" of the exception, *Dewsnup*, 502 U.S. at 419, or for interpreting "silence" in the legislative history as implicit acceptance of the exception. On the contrary, "[t]here is no reason to suspect that Congress did not mean what the language of the statute says," *Ron Pair*, 489 U.S. at 246 — and the language of the statute provides in no uncertain terms for an absolute priority rule that is not subject to any exceptions.

B. The Bankruptcy Code Varies Considerably From The Bankruptcy Scheme That Spawned The *Case* Dicta

There is another reason, to which we have already alluded several times, why Congress's failure to mention the new value exception when enacting the Bankruptcy Code cannot be taken as tacit acquiescence in the exception. The bankruptcy scheme that existed in 1939 — and that prompted the *Case* dicta — was significantly different from the Bankruptcy Code adopted in 1978.

When Congress enacted the Bankruptcy Code in 1978, it fundamentally changed the law of reorganization in ways that removed any need or basis for the new value exception proposed in *Case*. As noted earlier, Congress replaced three disparate statutory schemes with a single one, Chapter 11, that "differ[s] markedly from the prior law." *Greystone*, 995 F.2d at 1282, 1285 (Jones, J., dissenting). Chapter 11 "'reflects a melding of concepts derived from several * * * distinct bodies of pre-Code law'"; Congress's "'conscious purpose'" was to "'create a new chapter that represented the best of all of these approaches to reorganization.'" Pet. App. 43a (Kanne, J., dissenting) (quoting *In re A.V.B.I., Inc.*, 143 B.R. 738, 746-747 (C.D. Cal. 1992)); see also H.R. Rep. No. 95-595, at 223-224 ("Chapter X has become an unworkable procedure, and chapter XI is inadequate to fill the void"; the new chapter 11 "adopts much of the flexibility of chapter XI of current law, and incorporates the essence of the public protection features of current chapter X").

Most significantly for purposes of this case, the statute provides for consent to a plan by votes of specified majorities of all classes, 11 U.S.C. § 1126(c), and the "fair and equitable" test applies only if class acceptance does not occur, 11 U.S.C. § 1129(b)(1). These changes mean that, if *Case* arose today, a new value exception would not be needed to ensure continued shareholder control; the vote in that case — approval by more than 90% of each class of creditors, 308 U.S. at 111-112 — would satisfy Section 1126(c) of the current Code. BAIRD, *supra*, at 262. Moreover, the Code in-

cludes an elaborate definition of the "fair and equitable" standard, 11 U.S.C. § 1129(b)(2)(A)-(C), and nothing in that definition mirrors the new value dicta articulated in *Case*. Chapter X, in contrast, had *no* definition of "fair and equitable."

These features of Chapter 11 "represent[ ] a significant change from pre-Code bankruptcy law and arguably render[ ] the new value exception unnecessary." Pet. App. 43a (Kanne, J., dissenting); see also *Greystone*, 995 F.2d at 1282, 1285 (Jones, J., dissenting). The new value exception proposed in the *Case* dicta "gave plan proponents some leverage when dealing with an obstinate *minority* of creditors who would otherwise block confirmation," but "there is no longer any need for such an exception under the [Code], given the revised confirmation standard of section 1129." EPSTEIN, ET AL., *supra*, at 844-845; see also *Kham & Nate's Shoes*, 908 F.2d at 1361. Under the Code, the absolute priority rule applies "only to the claims of dissenting *classes* of creditors impaired by the plan, and not to the claims of individual dissenters within an accepting class." Gangemi & Bordanaro, *supra*, 1 AM. BANKR. INST. L. REV. at 186-187 (emphasis added). But if each class of impaired creditors votes to accept the plan, the Code permits pre-bankruptcy equity holders to retain an interest in the debtor "even when an impaired class of creditors is not being fully compensated under the plan, and even when certain of such creditors have not actually accepted the plan" — a result "not possible under the Bankruptcy Act." Brian A. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 COM. L.J. 290, 301 (1996); see also Miller, *supra*, 77 B.U. L. REV. at 1011 ("The new value exception never constituted an exception to the will of the creditors, but rather an exception to an unwaivable rule of law, the absolute priority rule."); *id.* at 1024 ("[T]he exception can only be employed when one or more classes of creditors or shareholders do not want shareholder participation. Such an exception has never existed. To write it into the law is to create new law.").

The environment in which plans of reorganization are implemented is also considerably different today. In 1939, independent trustees controlled management of the debtor during reorganization proceedings; any plan that permitted prior equity holders to remain in place required trustee approval; and, before approving any such plan, the trustee "presumably would have examined the books and operations and would have unearthed any dishonesty or mismanagement" by the previous owners. *A.V.B.I.*, 143 B.R. at 743; see also Pet. App. 44a (Kanne, J., dissenting); *Coltex*, 138 F.3d at 44. In contrast, most businesses filing for reorganization under the current Chapter 11 are operated by debtors-in-possession, and "the former protections against self-dealing afforded by trustee * * * control are no longer present." *Coltex*, 138 F.3d at 44. A new value plan today thus presents a very real danger — "'uninterrupted control by insiders,'" exercised "'for the private benefit of existing salaried management and the equity holders, with the intent of unfairly squeezing out the creditors'" — that simply did not exist in 1939. Pet. App. 44a (Kanne, J., dissenting) (quoting *A.V.B.I.*, 143 B.R. at 743); see also Miller, *supra*, 77 B.U. L. REV. at 1005-1006.

Finally, as part of its new approach to reorganization, Chapter 11 struck "a considered balance between creditor and debtor interests, which creditors, debtors, and courts must scrupulously respect." *Coltex*, 138 F.3d at 44. Congress drew from diverse bodies of pre-Code law in creating Chapter 11, and "[n]one of these predecessors contained the same balance of creditors' voting rights, pre-filing management's operational controls, and disclosure and confirmation standards." *A.V.B.I.*, 143 B.R. at 746. The Code's "comprehensive overhaul" of the law of reorganization thus "recalibrated the allocation of powers between debtors and creditors in a multitude of provisions." *Id.* at 743. The "fair and equitable" standard defined in Section 1129(b) is one part of this larger effort, and engrafting a judge-made new value exception on that statutory definition would "upset the balance sought to be achieved by Congress." *Coltex*, 138 F.3d at 44.

Given the fundamental alteration of the law of reorganization, the court of appeals improperly failed to heed this Court's admonition that, when the Code "substantial[ly]

change[s]" pre-Code practice, prior law should not be deemed incorporated into the Code. *Wolas*, 502 U.S. at 160 (refusing to import prior law into the Code because the pre-Code rule developed when the statute "was significantly narrower than it is today"). The Court so held in *Wolas* even though pre-Code cases had actually adopted a "rule" on the question at issue there, *id.* at 158; here, of course, the new value exception rests on a far more "tenuous" footing. Pet. App. 46a (Kanne, J., dissenting).

In light of the dramatic changes made in 1978 to the statutory framework for reorganizations, there is no basis for concluding that Congress meant to continue the use of an exception founded on dicta written in a significantly different legal environment. This is particularly true given that those dicta had never been followed in the ensuing four decades, the legislative history does not contain a single reference to a new value exception, and the Code as enacted effectively addresses the problem that spawned the *Case* dicta in the first place (the ability of a minority of unconsenting creditors in a class to block a new-value plan by insistence on absolute priority). Congress "carefully reexamined and entirely rewrote" the absolute priority rule in 1978; this "supports the conclusion that the text * * * as enacted reflects the deliberate choice of Congress," *Wolas*, 502 U.S. at 160 — and the text of Section 1129(b) simply does not contain a new value exception.

As Judge Kanne concluded, "cutting and pasting pre-Code practice into a fundamentally different bankruptcy context" results in a "new" statute "that Congress likely never intended." Pet. App. 46a. Faithfulness to the intent of Congress requires that the Court read the Code as written, not by reference to wholly unrealistic presumptions that Congress intended to continue an illusory pre-Code practice under the radically different provisions of the Code.[23]

[23] Some commentators perceive that two different strands of interpretation of the Code dominate this Court's precedents: careful parsing of the statutory text, as in *Ron Pair;* and interpretation of the Code by reference to pre-Code law and attention to the question whether Congress made clear its intent to change the law, as in *Dewsnup*. See BAIRD, *supra*, at 261 n.21. The latter approach is controversial among the Members of this Court. See, *e.g.*, *Dewsnup*, 502 U.S. at 432-436 (Scalia, J., dissenting). Because the very purpose of the Code was to rewrite and replace all prior law on the subject, it is hazardous to overemphasize pre-Code practice in interpreting the Code. No matter how much clarity one demands in the Code and its legislative history before finding a departure from pre-Code practice, however, the result reached by the Seventh Circuit is indefensible. The court below labored mightily to find ambiguity in a statute that is not in fact particularly difficult to read, and then it relied on a serious misunderstanding of the context within which pre-Code precedent was decided to import principles from inapposite pre-Code authority into the Code. The clarity of the law suffers from an interpretive approach that invites such a broad-ranging inquiry, and produces such erroneous results.

IV. A NEW VALUE EXCEPTION WOULD BE INCONSISTENT WITH FUNDAMENTAL BANKRUPTCY CODE POLICIES

Besides having no basis in the statutory text or the legislative history, a new value exception is inconsistent with the basic principles that undergird the Bankruptcy Code. And given the statutory framework that Congress adopted, it had good reasons not to enact a statute that included a new value exception to the absolute priority rule.

1. To begin with, a new value exception would turn the bankruptcy priority scheme on its head. The exception does more than permit prior equity holders to participate in the reorganized entity. It gives the parties in interest with the *lowest* legal priority the ultimate right to control a debtor and its property, even when their pre-petition economic position in the debtor has become valueless and senior, unsecured creditors, who will not receive payment in full of their claims, object to permitting prior equity holders to retain their stake in the business. This is contrary to a fundamental precept of the Bankruptcy Code: "the interests of shareholders become subordinated to the interests of creditors." *CFTC* v. *Weintraub*, 471 U.S. 343, 355 (1985). "Creditors effectively own bankrupt firms," *Kham & Nate's Shoes*, 908 F.2d at 1360, and whether creditors would be "better off" under a

proposed plan of reorganization is a "determination * * * for the creditors to make." *Ahlers*, 485 U.S. at 207.

This case provides a striking illustration of the vices inherent in using a new value plan to permit continued control of a debtor by the pre-petition equity holders rather than creditors, as Chapter 11 contemplates. The new value plan here prevents the bank from foreclosing and therefore from discovering for itself whether, as the bank in fact believes to be the case, the Property has a value greater than the $55.8 million found by the bankruptcy court — whether in fact it could receive a recovery on its $38.5 million unsecured claim today greater than the zero recovery on that claim that the bankruptcy judge found the bank would have received had it been instead permitted to foreclose.[24]

Instead, the plan deprives the bank of this right, providing the bank with only 16% of the present value of its $38.5 million unsecured claim. Pet. App. 28a, 133a. It does so in order (a) to perpetuate the existence of a debtor that, as the debtor has acknowledged, is "worthless in a balance sheet sense," Br. in Opp. 19, and (b) to permit the debtor's pre-petition equity holders — who will *never* have an economic stake in the Property itself — to protect themselves from the adverse personal income tax consequences they would have experienced had the bank been permitted to foreclose.[25]

[24] The bankruptcy court valued the Property at $55.8 million. Any amount actually received upon the foreclosure of the bank's "secured" claim in excess of that amount would, of course, constitute a dividend on account of the bank's $38.5 million unsecured claim. In that event, the bank would be immediately entitled to such a dividend — it would not have to wait the ten years of the debtor's plan and it would not have to endure the risks inherent in the debtor's plan, including the $5 million cash flow shortfall in years seven and eight of the plan. But most important, the bank, as the only non-insider creditor under the plan not receiving payment in full in cash on the effective date of the plan, would have (instead of being deprived of) an opportunity to have the Property subjected to the market — to learn what the true value of the Property (and thus of its "unsecured" claim) is.

[25] See *Coltex*, 138 F.3d at 46 (approving a new value plan "for the benefit of insiders" would stymie a creditor "in its legitimate attempts to obtain the value of its claims"); *Greystone*, 995 F.2d at 1282, 1285 (Jones, J., dissenting) (a new value exception "permits [an] egregious alteration of rights without the secured creditor's consent"); Lawrence B. Gutcho, *Real Estate Lenders and the Battle Over "New Value,"* 110 BANKING L.J. 423, 424-425 (1993).

Chapter 11 was intended to "enabl[e] business operations that have *positive* value to carry on." *In re UNR Indus., Inc.*, 20 F.3d 766, 771 (7th Cir. 1994) (emphasis added). It was not designed to permit "valueless" (Br. in Opp. 19) business enterprises to continue in operation, for the benefit of inside investors, while the claims of senior creditors are unpaid.

To paraphrase Professor Miller's description of another recent case: "Running through the" Seventh Circuit's "opinion is the sense not that this is an asset belonging to creditors who will lose [84%] of their unsecured claims, but rather that somehow the old owners have an interest and should have a right to redeem it. This approach runs against the Code itself, its legislative history, and the history that preceded it." 77 B.U. L. REV. at 1021.

2. When the debtor's pre-bankruptcy equity holders are given the *exclusive* right to acquire interests in the reorganized entity in return for a contribution of new value, the new value exception permits the debtor's insiders effectively to sell the debtor's property to themselves on their own chosen terms. The only check on abuse of that power is a bankruptcy judge's necessarily imperfect attempt at valuation — instead of the market discipline that would be provided if there were competitive bids from creditors or outsiders. See *Coltex*, 138 F.3d at 44 (noting the danger of "self-dealing"). No provision in Chapter 11 of the Code permits this type of self-interested conduct by the debtor's owners. See *A.V.B.I.*, 143 B.R. at 747. Indeed, case law under 11 U.S.C. § 363, the principal Code provision governing the sale of assets, flatly prohibits such closed, insider-only sales. *E.g.*, *In re W.A. Mallory Co.*, 214 B.R. 834, 838 (Bankr. E.D. Va. 1997).

Neither pre-Code law nor the Code was ever intended to allow such self-dealing. At the time of *Case*, "a disinterested, independent trustee, rather than the very interested inside debtor, would formulate the reorganization plan." Miller, *supra*, 77 B.U. L. REV. at 998. The Securities and Exchange Commission also oversaw most corporate reorganizations. *Ibid.* "SEC oversight and plan formulation by an independent trustee would assure shareholders' participation at creditors' detriment only in cases of true necessity." *Id.* at 1000-1001. But "[d]isclosure is the heart of the new Code, replacing the SEC and the independent trustee as a bulwark against fraud." *Id.* at 1005. These changes "counsel against the survival of a new value exception." *Id.* at 1018.

3. The new value exception also improperly injects the judiciary into what should be the creditors' business decisions. "[T]he Code provides that it is up to the creditors — and not the courts — to accept or reject a reorganization plan which * * * fails to honor the absolute priority rule." *Ahlers*, 485 U.S. at 207; see also *Greystone*, 995 F.2d at 1283, 1285 (Jones, J., dissenting) (Chapter 11 embodies the principle of "creditor control"). This is the creditors' "prerogative under the Code, and courts applying the Code must effectuate their decision." *Ahlers*, 485 U.S. at 207.

The new value exception reverses the roles of creditors and courts. It "means a power in the judge to 'sell' stock to the managers even when the creditors believe that this transaction will not augment the value of the firm," *Kham & Nate's Shoes*, 908 F.2d at 1360, or otherwise be in their best interests. And because of the deferential standard of review — the multi-factor test often proposed to evaluate new value plans[26] is "exceedingly vague" and "essentially factual" — "each bankruptcy court can impose its freewheeling view of reorganization policy without fear of appellate reversal." *Greystone*, 995 F.2d at 1283-84, 1285 (Jones, J., dissenting).

[26] Courts that have adopted a new value exception disagree on some of the factors that should be considered to determine whether the exception is satisfied. See *Coltex*, 138 F.3d at 45 n.5.

The Code does not give bankruptcy judges this power, and for good reason: "It is dubious to suppose that courts will ordinarily possess superior foresight than the creditors themselves concerning the creditors' best interests." *Ibid.*

4. Any judge will have difficulty in placing a value on a business enterprise. "A firm is very hard to value" even in the best of circumstances, and, because the existing shareholders necessarily have "superior knowledge about the firm," "a bankruptcy judge is not going to be as well informed as the shareholders about what its true value is." BAIRD, *supra*, at 262. This means that equity holders can wait to see whether the judge undervalues the firm, and only then commit themselves to invest in it. Thus, shareholders typically will propose new value plans when they

> are gaining at the creditors' expense. * * * In operation, the new value exception is going to systematically favor the shareholders at the creditors' expense. The shareholders do not have to plunk down any money until after they see how the judge has valued the firm. They get to place their bets after they see the other person's cards.

Id. at 263; see also Strub, *supra*, 111 BANKING L.J. at 245 (valuation is turned into a "game" in which "uncertainty [is] inherent" when, as with the new value exception, there is no "market determination of value"); Miller, *supra*, 77 B.U. L. REV. at 997-998 & nn.156-158, 1018-1019.

5. Establishment of a new value exception would also undermine bankruptcy policy in the context of consensual plan negotiations. "Negotiations are the lifeblood of a corporate reorganization," BAIRD, *supra*, at 266, and whether there is a new value exception "has significant implications for the relative bargaining power of debtors and creditors in Chapter 11 cases," *Bonner Mall*, 2 F.3d at 901. As Judge Jones has cautioned (*Greystone*, 995 F.2d at 1283, 1285 (dissent)):

> [P]ermitting the courts, pursuant to a "new value exception," rather than the creditors, under a strict absolute priority rule, to determine the conditions of former equity owners' participation in a reorganized debtor introduces

an enormously complicating factor in a carefully balanced bargaining structure.

This is because the absolute priority rule, when "applied rigorously," acts as a "powerful brake on the debtor's behavior and a strong influence on the negotiation that is likely to occur over a reorganization plan" — it "make[s] the debtor more willing to negotiate" with creditors. EPSTEIN, ET AL., *supra*, at 839. But if the absolute priority rule is watered down with a new value exception, there is a risk, as just noted, that the debtor's appraiser will convince "a sympathetic judge * * * that the value of the property in the bankruptcy estate is much lower than the creditors believe it to be." *Ibid.* This will decrease the amount paid to creditors, while at the same time permitting the debtor's pre-bankruptcy equity holders to retain an ownership interest in the post-bankruptcy business at a bargain price. *Ibid.*; BAIRD, *supra*, at 262-263; Miller, *supra*, 77 B.U. L. REV. at 1020. If, on the other hand, the absolute priority rule is "applied rigorously," each class of creditors can protect itself against the possibility of a "small recovery" (or an otherwise unacceptable reorganization scheme) by "vetoing the plan." EPSTEIN, ET AL., *supra*, at 839.

The "threat" of a new value plan thus "is often a powerful consideration at the negotiating table," Trost, et al., *supra*, SB37 ALI-ABA at 620; "[n]egotiations between creditors and the debtor against such a 'new value exception' backdrop [are] enormously skewed in favor of old equity and would seriously erode the utility of the creditors' votes." *Greystone*, 995 F.2d at 1284, 1285 (Jones, J., dissenting). As a result, the negotiations that occur in all Chapter 11 proceedings will be shaped largely by whether the absolute priority rule is limited by a new value exception. In the end, the identity of the constituency that will determine the ultimate outcome of Chapter 11 cases when the debtor is insolvent — senior, unsecured creditors or the debtor's pre-bankruptcy equity holders — will depend on the answer to the question presented in this case. And it is clear from both the Code itself and its underlying policies that senior, unsecured creditors,

rather than the holders of the insolvent debtor's equity interests, are to be that constituency.

In enacting the Bankruptcy Code, Congress intended to promote consensual plans and, at the same time, maintain the integrity of the absolute priority rule. It did so by granting the debtor the exclusive initial right to propose a plan of reorganization, see 11 U.S.C. § 1121, but providing that a plan ultimately could not be confirmed over its rejection by a dissenting class of creditors without satisfying the absolute priority rule. Thus, Congress placed the initial bargaining leverage in the hands of the debtor through its exclusive right to first propose a plan, but intended the *ultimate* leverage to be with the creditors pursuant to the absolute priority rule. See generally *Coltex*, 138 F.3d at 44 (discussing "the balance sought to be achieved by Congress" in Chapter 11). A new value exception eviscerates this congressional design by vesting both the initial *and* the ultimate leverage in the debtor's pre-bankruptcy equity holders.

6. The panel majority speculated, without citation, that the new value exception "has been a major source of new funding in reorganizations for the past fifty years" and that the absence of a new value exception might threaten "the continued existence[ ] of many corporate entities." Pet. App. 21a-22a. Aside from the factual dubiousness of that statement, discussed earlier, it simply ignores the ability of creditors to consent to a new-value plan.

Rational creditors will *consent* to a plan that involves an infusion of new value when, in their estimation, it truly is in the best interests of creditors and the estate. See *Bryson*, 961 F.2d at 504; *Kham & Nate's Shoes*, 908 F.2d at 1360. In this as in any other negotiation, if it is really true that there is a plan that is better for all concerned than is the default judicial rule — absolute priority — then back-and-forth between the parties is far more likely to produce such a result than is judicial fiat. The true policy issue in new value cases is not whether it is advisable to permit old equity holders to participate by contributing new value, but whether *a bankruptcy judge* should be able to *force* dissenting creditors of an

insolvent debtor to participate in such a plan by telling them that they have misperceived their own best interests.[27]

In any event, even if pre-bankruptcy equity holders were a significant source of reorganization funding in 1939, when the country was not yet out of the Depression, today's capital markets make it much easier for worthwhile ventures to obtain financing. See Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. CHI. L. REV. 651, 672 (1974) ("Current data do not support the belief that old shareholders are a fruitful source of additional funds when the public capital markets are unlikely to provide funds. In recent years shareholders have seldom contributed new capital."). More particularly, empirical evidence supports the proposition that creditors often consent to plans that would violate the absolute priority rule. See, *e.g.*, Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990). A reorganized company's inability to induce creditor consent *or*

[27] Courts that endorse a new value exception have offered the ability to engage in such judicial second-guessing as a positive virtue of the exception. See *In re Snyder*, 967 F.2d 1126, 1129-1130 (7th Cir. 1992) (business judgment of creditors in rejecting plan may not warrant exclusion of old equity). This is contrary to fundamental bankruptcy policy. See *Ahlers*, 485 U.S. at 207 ("the Code provides that it is up to the creditors — and not the courts — to accept or reject a reorganization plan"). It is also contrary to the specific statutory provisions of 11 U.S.C. § 1126(e). That statute permits the bankruptcy judge to discard a creditor's vote, "[o]n request of a party in interest, and after notice and a hearing," *only* upon finding that "such acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title." A vote cast based on a *creditor's* assessment of its own economic interest is always cast in good faith. See *John Hancock Mut. Life Ins. v. Route 37 Bus. Park*, 987 F.2d 154, 161-162 (3d Cir. 1993); *In re Federal Support Co.*, 859 F.2d 17, 20 (4th Cir. 1988). (Not surprisingly, the debtor did not challenge the propriety of the bank's votes under 11 U.S.C. § 1126(e). See Pet. App. 114a-128a.) Thus, this type of judicial second-guessing under the guise of application of the new value exception runs afoul of 11 U.S.C. § 1126(e).

to convince anyone other than a pre-petition equity holder to lend it money today suggests not a failure of the capital markets as much as a realistic assessment that the reorganization is unlikely to succeed.

7. Chapter 11 "embodies the general Code policy of maximizing the value of the bankruptcy estate." *Toibb*, 501 U.S. at 163. In the long run, however, a new value exception is more likely to undermine than to further that policy. It will tend to give a new, but short, lease on life to a company that may expire thereafter with assets whose value has further eroded. Many Chapter 11 reorganizations are unsuccessful; according to one study, approximately 40% of all Chapter 11 cases are eventually converted to Chapter 7 liquidations. Basil, *supra*, 101 COM. L.J. at 304 & n.90. By the time the debtor's assets are liquidated in a Chapter 7 proceeding,

> it is probable that any funds reinvested by debtor's shareholders will have dissipated, and the hard assets from which the unsecured creditors ultimately receive payment will have depreciated. Thus, the net result of having applied the new value exception will have been to diminish, rather than maximize, the value of the estate from the perspective of unsecured creditors.

Id. at 304; see also James J. White, *Absolute Priority and New Value*, 8 COOLEY L. REV. 1, 29-31 (1991) (the purported economic benefits of a new value exception are "speculative"; "it seems more probable than not that abolition of the new value exception will enhance, not diminish, the efficiency of the most probable plans").

8. At bottom, a new value exception is contrary to the underlying premise of equity ownership in an enterprise: in exchange for its greater potential for return, equity takes the greater risk of loss. See Basil, *supra*, 101 COM. L.J. at 302-303. It is antithetical to the principles underlying the absolute priority rule to permit a debtor's equity holders, who would have kept all of the profits in the enterprise had there been any, to shift the risk of loss to a senior class of creditors when business turns sour, yet retain the exclusive right to

continue to own and control the reorganized debtor through the contribution of new value.

"New value has gone from a regrettable but necessary incursion into creditors' rights to an accepted means for the owners of debtors to cancel debt and keep ownership. No matter how history is read, this was never one of the new value exception's purposes." Miller, *supra*, 77 B.U. L. REV. at 1022. The Bankruptcy Code "was not meant to provide a way for owners of * * * partnerships[ ] to keep the ownership without paying the debts." *Ibid.* The Court should decline to read the Code in such a fashion.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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ADDENDUM

SECTION 1129 OF THE BANKRUPTCY CODE (11 U.S.C. § 1129)

§ 1129. Confirmation of plan

In this title—

(a) The court shall confirm a plan only if all of the following requirements are met:

* * *

(8) With respect to each class of claims or interests —
(A) such class has accepted the plan; or
(B) such class is not impaired under the plan.

* * *

(b) (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides —

(i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the

allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims —

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests —

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order

of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

(19)

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In the Supreme Court of the United States

OCTOBER TERM, 1998

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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REPLY BRIEF FOR THE PETITIONER

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29 pp

UPDATED RULE 29.6 STATEMENT

The Rule 29.6 statement contained in the opening brief for the petitioner remains accurate, except that the merger of BankAmerica Corporation and NationsBank Corporation is now scheduled to occur on September 30, 1998.

TABLE OF CONTENTS

Page

REPLY BRIEF FOR THE PETITIONER 1

I. THE PLAIN STATUTORY LANGUAGE DOES NOT INCLUDE A NEW VALUE EXCEPTION 3

II. THE LEGISLATIVE HISTORY DOES NOT SUPPORT ADOPTION OF A NEW VALUE EXCEPTION 12

III. CONGRESS DID NOT TACITLY ADOPT A NEW VALUE EXCEPTION IN 1978 13

IV. THE POLICY ARGUMENTS ADVANCED BY THE DEBTOR AND ITS AMICI DO NOT SUPPORT CREATION OF A NEW VALUE EXCEPTION 16

CONCLUSION 20

TABLE OF AUTHORITIES

Cases **Page**

Associates Commer. Corp. v. *Rash*, 117 S. Ct. 1879 (1997) . 16

Case v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) 14, 15

Chicago R.I. & P.R.R. v. *Howard*, 74 U.S. 392 (1868) 15

Cohen v. *De La Cruz*, 118 S. Ct. 1212 (1998) 8

Coltex Loop Central Three Partners, L.P., In re, 138 F.3d 39 (2d Cir. 1998) 4

Delta Resources, Inc., In re, 54 F.3d 722 (11th Cir. 1995) . . 16

Evenson, In re, 165 B.R. 27 (Bankr. E.D. Mich. 1994) 8

Exxon Co. v. *Sofec, Inc.*, 517 U.S. 830 (1996) 6

Handy Andy Home Improve. Centers, Inc., In re, 144 F.3d 1125 (7th Cir. 1998) 3

Holmes v. *SIPC*, 503 U.S. 258 (1992) 6

Jerome B. Grubart, Inc. v. *Great Lakes Dredge & Dock Co.*, 513 U.S. 527 (1995) 6

Kansas City Terminal Ry. v. *Central Union Trust Co.*, 271 U.S. 445 (1926) 14, 15

Kham & Nate's Shoes No. 2, Inc. v. *First Bank*, 908 F.2d 1351 (7th Cir. 1990) 17

Louisville Trust Co. v. *Louisville, N.A. & C. Ry.*, 174 U.S. 674 (1899) 15

Midlantic Nat'l Bank v. *New Jersey Dep't of Envt'l Protec.*, 474 U.S. 494 (1986) 15

Morales v. *TWA*, 504 U.S. 374 (1992) 1

Northern Pac. Ry. v. *Boyd*, 228 U.S. 482 (1913) 15

Norwest Bank Worthington v. *Ahlers*, 485 U.S. 197 (1988) . . . . . *passim*

O'Gilvie v. *United States*, 117 S. Ct. 452 (1996) 5, 6

Price Waterhouse v. *Hopkins*, 490 U.S. 228 (1989) 6, 7

Resorts Int'l, Inc., In re, 145 B.R. 412 (Bankr. D.N.J. 1990) 14

Serbin v. *Bora Corp.*, 96 F.3d 66 (3d Cir. 1996) 6

Textron Lycoming Recip. Eng. Div. v. *UAW*, 118 S. Ct. 1626 (1998) 6

United Sav. Ass' n v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) 16

Statutes **Page**

11 U.S.C. § 506(b) 16

11 U.S.C. § 522(d)(10)(E) 8

11 U.S.C. § 547(a)(2) 12

11 U.S.C. § 547(c)(1) 12

11 U.S.C. § 547(c)(3) 12

11 U.S.C. § 547(c)(4) 12

11 U.S.C. § 1111(b) 18

11 U.S.C. § 1111(b)(1)(A) 8

11 U.S.C. § 1129 . . . . . 2, 8

11 U.S.C. § 1129(a)(10) 18

11 U.S.C. § 1129(a)(7) 10, 19

11 U.S.C. § 1129(a)(7)(A)(ii) 8

11 U.S.C. § 1129(a)(7)(B) 8

11 U.S.C. § 1129(b) 2, 14, 15

11 U.S.C. § 1129(b)(2) 1, 5, 6, 12, 13

11 U.S.C. § 1129(b)(2)(B)(i) 2, 8

11 U.S.C. § 1129(b)(2)(B)(ii) 1, 4, 5, 6, 7, 8, 12

11 U.S.C. § 1129(b)(2)(C)(i) 8

11 U.S.C. § 1129(b)(2)(C)(ii) 8

11 U.S.C. § 1225(b)(1)(B) 12

11 U.S.C. § 1325(b)(1)(B) 12

42 U.S.C. § 2000e-2(a)(1) 7

Internal Revenue Code § 104(a)(2) 6

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DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY (1993) 11, 14, 17, 18

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5 COLLIER ON BANKRUPTCY ¶ 1129.03[e][i] (L. King 15th ed. 1996) 5

7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c][iii] (L. King 15th ed. rev. 1997) 5, 18

H.R. Rep. No. 95-595 . . . . . 2, 10, 11, 12, 13, 17

Kenneth N. Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229 (1990) 4, 14

Lynn M. LoPucki, *The Debtor in Full Control — Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 99 (1983) 16

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Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47 (1997) 18

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REPLY BRIEF FOR THE PETITIONER

The only question before this Court is whether the debtor's pre-petition equity holders "receive[d] or retain[ed] under the plan on account of [their prior equity] interest any property" even though the plan did not provide in full for a dissenting class — the bank's $38.5 million unsecured claim. 11 U.S.C. § 1129(b)(2)(B)(ii). The answer is an unequivocal "yes": under the plan, the debtor's pre-petition equity holders received a recognized property interest — the exclusive opportunity to retain the equity interests in the reorganized debtor through the contribution of new value — as a result of and thus "on account of" being pre-petition equity holders.

In trying to justify the result below, the debtor and its amici focus on their view of bankruptcy policy and misconstrue cases decided more than 70 years ago concerning the meaning of "fair and equitable" — all of which they maintain should somehow be more reflective of congressional intent at the time of the enactment of the Bankruptcy Code than the text Congress enacted in 1978. These arguments are not only mistaken, but irrelevant; congressional intent is best expressed by the statutory language, which does not provide for a new value exception to the absolute priority rule.[1]

The debtor's arguments about the statutory text are unconvincing. The debtor concedes that its pre-petition equity holders "obviously" received "property" under the plan. Resp. Br. 10. But, the debtor argues, "on account of" in Section 1129(b)(2) means proximate cause, not "but-for" cause, and the equity holders' contribution of new value, not their status as pre-petition equity

---

[1] The debtor and its amici contend that prior judicial definitions of "fair and equitable," rather than the elaborate definition of the same phrase in Section 1129(b)(2), should control this case. They invoke in support of that contention the principle that Congress makes its intent specific when it intends to change the interpretation of a judicially created concept. They assert, remarkably, that Congress "*evinced no inftenJtion to change*" the meaning of the term "fair and equitable," and that "this Court should presume that Congress intended the Bankruptcy Code to incorporate *all aspects* of pre-Code 'fair and equitable' jurisprudence." Org. Br. 19 (emphasis added). We are at a loss to understand what Congress is supposed to do to evince an intent to supplant the judicial interpretation of a previously defined phrase with a different definition, if *defining the term differently in the statute* does not evince such an intent. "[L]egislative history need not confirm the details of changes in the law effected by statutory language before we will interpret that language according to its natural meaning." *Morales* v. *TWA*, 504 U.S. 374, 385 n.2 (1992).

holders, was *the* proximate cause of their acquisition of equity interests in the reorganized debtor. Resp. Br. 14-16, 19-20. But causation is not an all-or-nothing proposition. Events may have more than one proximate cause. Thus, even if Section 1129 requires proximate causation, it is clear that the debtor's prior owners received property "on account of" their prior interests — being a pre-petition equity holder was one of two indispensable prerequisites to receiving a post-confirmation ownership share. Because one of those proximate causes here is prohibited by Section 1129(b), it is irrelevant that the other cause does not violate the statute.

The 1978 legislative history supports this construction. That history does not even mention the new value exception, let alone endorse it. Instead, the House Report stated that junior classes cannot receive "anything" under the plan until senior classes are "paid in full." H.R. Rep. No. 95-595, at 413.

Here, the bank has not been "paid in full" for the $92 million it lent to the debtor ($93 million with interest). Far from it — the bank ultimately will receive payments with a present value of only about $60 million. Pet. Br. 6, 8.[2] Giving preference to junior interests by affording the debtor's prior owners the exclusive opportunity to control an insolvent debtor is particularly unwarranted here. The bankruptcy court found that the debtor was insolvent on the date of confirmation and will remain insolvent throughout the term of the plan. Pet. Br. 7. And the debtor was in business in the first place only because the bank lent it $92 million, secured by its only substantial asset, 15 floors of a Chicago office building. In return, the debtor promised to repay the loan by January 1995, and, if it did not do so, to allow the bank to foreclose. Pet. App. 103a. But as a result of the plan of reorganization, the bank — which holds more than 99.75% of the debtor's unsecured debt and is by far the debtor's largest creditor — is prevented from foreclosing and will not have anything approaching payment in full.

[2] The debtor's conclusory references to possible payment "in full" (Resp. Br. 4, 6-7) are a pipe dream. The debtor has *never* contested the bankruptcy court's finding that the bank will receive only about 16% of the present value of its $38.5 million unsecured claim. See Pet. Br. 6. This does not begin to satisfy the requirement that the bank receive *on the effective date of the plan* property with a present value equal to the full amount of the bank's unsecured claim, 11 U.S.C. § 1129(b)(2)(B)(i), and is hardly a "windfall" (Resp. Br. 42) — on a present-value basis, more than $30 million of the original loan will never be repaid to the bank.

This is inconsistent with Chapter 11's basic precepts: junior classes may not receive *anything* until senior classes are "'provided for in full,'" and "it is up to the creditors — and not the courts — to accept or reject a reorganization plan which fails to provide them adequate protection or fails to honor the absolute priority rule." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202, 207 (1988).[3] Permitting confirmation of plans like the one in this case over the objections of a dissenting class of unsecured creditors thus turns the priority scheme underlying the Bankruptcy Code on its head and effectively permits the debtor to sell its property to its own insiders without ever having to subject that property to market forces, which is prohibited by the Code.

I. THE PLAIN STATUTORY LANGUAGE DOES NOT INCLUDE A NEW VALUE EXCEPTION

1. The debtor does not dispute that an option to receive an equity interest in a business is "property" within the meaning of the statute. See Pet. Br. 15-16. Instead, the debtor's point seems to be that its prior equity holders were locked in to contribute new capital before the plan was confirmed; from that fact, the debtor somehow concludes that they did not receive the opportunity to own part of the post-petition entity *under* the plan. Resp. Br. 10-11, 22-28; Org. Br. 5-6, 23-25. But there is no textual basis in the statute for concluding that the validity of a new value plan depends on the timing of the prior equity holders' decisions to buy into the new firm. Nor are we aware of cases supporting the debtor's argument — courts typically reject Code interpretations that would permit substantive results to vary depending on the manipulable timing of business decisions. *In re Handy Andy Home Improve. Centers, Inc.*, 144 F.3d 1125, 1128-1129 (7th Cir. 1998). More important, regardless of when prior equity owners committed themselves to invest, they were the *only* persons allowed to contribute new capital to, and become owners of, the post-petition debtor. It is simply not true *under the plan* that there was "an unlimited universe of poten-

[3] NACM's view (at 9, 12) that Chapter 11 is "largely directed" at unsecured creditors and that the Code "sharply curtails the power" of dissenting senior creditors ignores the facts of this case, where the dissenting claim at issue is the bank's $38.5 million *unsecured* claim, and is contrary to both *Ahlers* and the absolute priority rule. The legislative history cited by NACM (at 10) concerns a Senate proposal, *rejected* by the House, for mandatory use of a public trustee for Chapter 11 proceedings involving public companies. See Markell Br. 19 & n.11.

tial investors." Resp. Br. 23. The whole purpose of the plan was that there be a *limited* universe of potential investors — a universe consisting *entirely* of the debtor's pre-petition equity holders. See Pet. Br. 23 & n.13.[4] "[T]he *exclusive* right to retain the debtor's property upon making a capital contribution is itself property" received on account of prior equity interests. *In re Coltex Loop Central Three Partners, L.P.*, 138 F.3d 39, 43 (2d Cir. 1998).

Giving prior equity holders the *exclusive* opportunity to become post-petition owners — while freezing out other potential investors, such as senior creditors with unpaid claims — not only violates Section 1129(b)(2)(B)(ii), but also has pernicious consequences.[5] As Professor Markell argues (at 25-26), because an "increased number of bidders * * * tends to increase" the "final price," the "last thing this Court should do is fashion a rule that eliminates or reduces competition for bankruptcy debtors." (Why he thinks this supports the debtor's position is a complete mystery to us.)[6] The authors of the other amicus briefs filed in support of the debtor have also previously condemned plans that provide old equity with the exclusive right to receive new equity interests. See Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 39 (old equity "may offer to buy any of the assets of the estate on the same terms as any other buyer," but "[n]othing in the Code" gives equity "a beneficial position. If courts are in fact giving them enhanced status, they should not do so."); Kenneth N. Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229, 244 (1990) ("[t]he vice of the new value exception is that it enables the debtor's

[4] The decision by some prior equity holders not to contribute (see Resp. Br. 4 & n.7) does not change that reality; an exclusive option does not cease to be a property interest simply because not all the option holders exercise the option.

[5] The debtor (at 11, 26-27) and NACM (at 19-20) misrepresent our position as being based on the debtor's exclusive right to propose a plan under Section 1121(b). As we have explained (Pet. Br. 6-7 n.4), plan proposal exclusivity is not the basis for our argument that prior equity holders receive property "on account of" their prior equity holder status under *any* plan (proposed by anyone) when the plan grants them the exclusive right to become post-petition owners.

[6] See also James W. Bowers, *Rehabilitation, Redistribution or Dissipation: The Evidence for Choosing Among Bankruptcy Hypotheses*, 72 WASH. U.L.Q. 955, 959, 963 n.34, 975 (1994) (concluding, based on empirical research, that equity in reorganized firms is valued much more highly if third parties bid for the equity than if it simply rests with the pre-petition equity holders).

owners to purchase an ownership interest based on a court-approved valuation without validation of the price in the market place"; "[a]t the very least, * * * chapter 11 creditors * * * should have the opportunity to match or exceed the pending offer").

2. The central issue here is whether the debtor's pre-petition owners received or retained any "property" under the plan "on account of" their prior equity interests. 11 U.S.C. § 1129(b)(2)(B)(ii). If so, then the plan *cannot* be "fair and equitable," because "the condition that a plan be fair and equitable with respect to a class *includes the following requirements*," 11 U.S.C. § 1129(b)(2) (emphasis added), and the mandate that the holder of a junior interest *not* "receive or retain under the plan on account of such junior claim or interest any property" is one of those "include[d]" "requirements." *Id.* § 1129(b)(2)(B)(ii).[7]

The debtor argues that Congress, in using the phrase "on account of" in Section 1129, had in mind a proximate cause standard, not but-for causation. According to the debtor, the partners' contribution of new value was *the* proximate cause of their retention of equity interests, so they did not retain those interests "on account of" their pre-petition interests. Resp. Br. 14-15, 19-22. The debtor relies on *O'Gilvie* v. *United States*, 117 S. Ct. 452, 454-455

[7] Professor Markell denies that a plan *must* meet all the requirements of Section 1129(b)(2) to be considered "fair and equitable." According to him, the section merely provides "non-exclusive examples of compliance with the 'fair and equitable' rule." Markell Br. 2. What the Code calls "requirements" are, he claims, mere non-exclusive examples because Section 1129(b)(2) "introduces the various examples with the word 'includes,' which under the Code is expressly non-inclusive [*sic*]." *Id.* at 21. The flaw in that argument is painfully obvious. The direct object of the word "includes" is "requirements." The plain meaning of non-exclusively "includ[ing]" specified "requirements" is that a court may impose *additional* "requirements." See Pet. Br. 18 n.10. It is not that a court may treat the specified "requirements" as optional or as mere "examples." To say that the qualifications for President of the United States "include the requirement that she be at least 35 years old" cannot possibly mean that a 30-year-old is eligible just because the word "includes" is non-exclusive. Notably, this tortured interpretation of "includes" is the foundation on which Professor Markell has built not only his amicus brief, but also his entire textual analysis in both *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69 (1991), and 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c][iii] (L. King 15th ed. rev. 1997) (written by Professor Markell). Before Professor Markell assumed authorship of the relevant chapter of *Collier*, the treatise took the opposite position. See 5 COLLIER ON BANKRUPTCY ¶ 1129.03[e][i] (L. King 15th ed. 1996).

(1996), where this Court held that "on account of" in Internal Revenue Code § 104(a)(2) means "by reason of, or because of," and that "proximate" rather than "but-for" causation best reflects the meaning of those words. *O'Gilvie* is consistent with normal usage of the phrase. See U.S. Br. 11-12; see also *Textron Lycoming Recip. Eng. Div.* v. *UAW*, 118 S. Ct. 1626, 1629 (1998) (equating "because of," "on account of," and "in consequence of").

Statutory language, however, must be construed in the context in which it is used. *O'Gilvie* notwithstanding, "on account of" in Section 1129(b)(2)(B)(ii) is most naturally read to denote but-for causation. See, *e.g.*, *Price Waterhouse* v. *Hopkins*, 490 U.S. 228, 262-263 (1989) (O'Connor, J., concurring) ("I disagree with the plurality's dictum that the words 'because of' do not mean 'but-for' causation; manifestly they do"). But the Court need not resolve, in this case, the type of causal connection required by Section 1129(b)(2). Even under a proximate cause test, it is clear that the prior equity holders' previous interest in the debtor was a proximate cause of their receipt or retention of property under the plan.

The fatal flaw in the debtor's argument is the assumption that events have only one cause. It is common for events to have multiple proximate causes. *Jerome B. Grubart, Inc.* v. *Great Lakes Dredge & Dock Co.*, 513 U.S. 527, 541 (1995) (referring to "the arguably proximate causes of the incident"); *Exxon Co.* v. *Sofec, Inc.*, 517 U.S. 830, 837 (1996) (several tortfeasors' acts may be "proximate causes of an injury"); *Serbin* v. *Bora Corp.*, 96 F.3d 66, 75 (3d Cir. 1996) ("'it is fundamental that there may be more than one proximate cause of an injury'"). The proximate cause standard eliminates causes that are "bizarre," *Grubart*, 513 U.S. at 536, but is satisfied when there is "some direct relation" between one event and another, *Holmes* v. *SIPC*, 503 U.S. 258, 268 (1992).

There is undoubtedly "some direct relation" between the prior owners' pre-petition status and their ability under the plan to retain a post-petition equity interest. Pre-petition equity holders were the *only* ones given the opportunity to receive post-petition ownership interests (and their sole motivation, avoiding $20 million in taxes, was tied to their pre-petition status). Pet. Br. 23 & n.13. As a matter of law, being a pre-petition equity holder was clearly "a proximate cause," *Grubart*, 513 U.S. at 541, of having a post-petition ownership interest here — it was a critical requirement, integrally rather than remotely tied to the results sought and

achieved by the plan. See Pet. Br. 20 & n.11. The plan barred other possible investors who were not pre-petition owners.

Such a plan violates Section 1129(b)(2)(B)(ii), which prohibits plans in which senior claims are not provided for in full and old equity holders retain an ownership interest because of their prior position. It does not matter that those ownership interests were *also* retained "'on account of' their contribution of new capital" (Resp. Br. 22), a proposition we have never contested. See Pet. Br. 22. To say that an event *does* have a cause that is not prohibited tells us nothing about whether it *also* has a prohibited cause.

NACM likewise commits a fatal flaw of logic in its one attempt to deal with the statutory language. According to NACM (at 16 (boldface emphasis added)), "The Code unambiguously permits old equity to participate if it receives something other than 'property' *or* if it receives property in some way other than 'under the plan' **or if it receives value 'on account of' something other than its pre-bankruptcy claim.**" The emphasized part of that sentence is false. The Code does not *permit* retention of property "on account of" something other than owning a junior interest. It *prohibits* retention of property "on account of" the junior interest.

As we observed in our opening brief (at 21-22), this Court has experience with construing statutes that prohibit taking specified actions "on account of" or "because of" specified motives or causes. See 42 U.S.C. § 2000e-2(a)(1) (forbidding discrimination "because of" sex). The Court likewise has experience dealing with actions motivated or caused by both the forbidden factor and other, non-forbidden factors. Never has the Court construed such statutes — as NACM would construe Section 1129(b)(2)(B)(ii) — as affirmative *permission* to act whenever *a* cause or motive is *not* forbidden. Rather, the Court has followed the statutory language and inquired into the role the *forbidden* motive played.[8] So too here, the relevant question is what role the pre-petition equity holders' status

[8] *Price Waterhouse*, 490 U.S. at 239-247 (plurality opinion); see also *id.* at 284 (Kennedy, J., dissenting) ("No one contends * * * that sex must be the sole cause of a decision before there is a Title VII violation. This is a separate question from whether consideration of sex must be *a* cause of the decision. Under the accepted approach to causation that I have discussed, sex is a cause for the employment decision whenever, either by itself or in combination with other factors, it made a difference to the decision.").

played in allowing them to receive or retain property. A focus on the role other causes played is irrelevant and a mere distraction.

3. The debtor and its amici also argue that "on account of" could mean "in exchange for" or "in consideration for." Resp. Br. 12-13, 15 n.16; Org. Br. 12-13. But they cite no cases that have adopted either definition. Nor are those definitions compatible with the normal meaning of the phrase or the way "on account of" is used in Section 1129 and other parts of the Code. See *Cohen* v. *De La Cruz*, 118 S. Ct. 1212, 1217 (1998) (courts "presum[e] that equivalent words have equivalent meaning when repeated in the same statute"); see also Pet. App. 36a-37a (Kanne, J., dissenting). The debtor's argument relies on the proposition that "on account of" has "mercantile origins" and refers to an "exchange of old pre-petition claims and interests for new rights." Resp. Br. 12-13. But Section 1129 uses "on account of" several times in sentences referring to the property that a "holder" of a "claim" or "interest" will "*retain*" "on account of" its "claim" or "interest."[9] If property is being *retained* — for example, if shareholders retain the same interest in a corporation without contributing new capital — there is no "exchange" and thus there can be no "consideration" for an exchange. When the Code uses "receive *or retain*" it necessarily uses "on account of" expansively to mean more than receipt "in exchange for" a claim or interest. Sense can be made of the word "retained" in Section 1129, and in other Code sections in which "on account of" appears,[10] only if "on account of" is given its natural meaning — "because of."

4. It is not true that we have proposed, or that our argument would require, an auction whenever pre-petition equity holders seek to contribute new money to retain their interests in the post-petition debtor. See Resp. Br. 21, 28 n.32; NACM Br. 16-19. Compare Pet. Br. 11 n.6. Rather, we contend that the Code prohibits plans

[9] See 11 U.S.C. § 1129(a)(7)(A)(ii), (a)(7)(B), (b)(2)(B)(i), (b)(2)(B)(ii), (b)(2)(C)(i), (b)(2)(C)(ii).

[10] See, *e.g.*, *In re Evenson*, 165 B.R. 27, 28 (Bankr. E.D. Mich. 1994) (cited at Org. Br. 13) (Section 522(d)(10)(E), which permits debtors to exempt payments under employer plans and contracts "on account of illness, disability, death, age or length of service," means "because of"); 11 U.S.C. § 1111(b)(1)(A) (treating certain claims as if the holder of the claim "had recourse against the debtor on account of such claims").

in which the debtor's pre-petition insiders are granted, in effect, the exclusive opportunity to sell the property to themselves.[11]

Thus, our position does not foreclose old equity from ever participating in the reorganized firm (see Org. Br. 5, 10-11, 25; NACM Br. 19), and the debtor's assertion (at 10) that our reading of the statute renders "on account of" superfluous is plainly wrong. Prior equity holders may participate if they prevail in an open auction, if they hold unsecured claims against the debtor, or if senior creditors consent. See Pet. Br. 22 n.12. In the first two instances, their post-petition interests would be solely "on account of" their superior bids or unsecured claims and not at all on account of their prior equity interests. In the third instance, the absolute priority rule is inoperative by its own terms. Pet. Br. 1-2. The contentions that we object to the "source of funds" (NACM Br. 10) and that our position "den[ies] access to capital" (*id.* at 14) are similarly erroneous. Prior equity holders are perfectly welcome to inject new capital as part of a Chapter 11 reorganization, but they must do it in a way that complies with the statute.

5. The debtor pretends that the only alternative to its plan is liquidation and that, as long as dissenting creditors are receiving

[11] The debtor suggests that the procedure approved by the Seventh Circuit in this case permits creditors to "'shop' that plan with the possibility that another more generous plan might be proposed and confirmed." Resp. Br. 29. Of course, the plan here had no feature that would permit such "shopping" or the making of any "higher or better" offer. Under the plan, the only possible purchase was to be done by the debtor's pre-petition equity holders. And the assertion that, if an auction had been held, "no one other than old equity holders * * * would have been a prospective bidder" (*id.* at 21 n.25) is preposterous. The bank, which believes the property is worth considerably more than its appraised value but still less than the loan amount, certainly would have been a prospective bidder, particularly because, as the debtor points out, every dollar bid by the bank beyond that required for the Property (up to the amount of its unsecured claim) would have had to have been returned to the bank on account of its $38.5 million unsecured claim. *Id.* at 28 n.32. This would not have been the action of a "shill" (*id.* at 29 n.32), but instead the economically rational action of an unsecured creditor with $38.5 million at stake trying to protect its claim. Unlike the exclusive opportunity the plan accords to those on the very bottom of the priority ladder, this scenario would have been consistent with the absolute priority rule. Finally, we did not state that "Section 363 prohibits a debtor from selling property to its shareholders." *Id.* at 48 n.58. What we said was that Section 363 prohibits "closed, insider-only sales," exactly the type of sales that the recognition of the new value exception would permit on the facts of this case. Pet. Br. 43.

more under a Chapter 11 plan than what a bankruptcy judge determines they would receive in a Chapter 7 liquidation, they have no right to complain. That view makes the absolute priority rule swallow the "best interests" test of 11 U.S.C. § 1129(a)(7), which is a *separate* prerequisite to confirmation and already requires that impaired creditors do at least as well under the proposed plan as they would in a Chapter 7 liquidation. Making the creditors at least as well off as they would be under liquidation is only a starting point for an acceptable plan, not the last question.

Moreover, there is a third alternative to confirmation of the debtor's plan and liquidation: negotiation. Indeed, "[t]he premise of the bill's financial standard for confirmation" was that "negotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders." H.R. Rep. No. 95-595, at 224. It is "[o]nly when the parties are unable to agree on a proper distribution" that the court may become involved and "confirm the plan anyway" — as long as it complies with the absolute priority rule. *Ibid.*; see also Pet. Br. 29-30, 44-47. The Code is structured so that the parties have the incentive to negotiate a plan that is acceptable to creditors and stockholders alike. The likelihood that that will occur is lessened substantially if one negotiator (the debtor) knows that a judge will bail it out.

6. Professor Markell argues that it can be shown "math[e]matically" that the new value exception is really part of the absolute priority rule when owners and third parties are free to participate "on the same terms." Markell Br. 3. Even if that is so, it has nothing to do with this case, because the critical assumption on which his mathematics depend is that third parties had the same opportunity as the debtor to bid "new value" for the equity. And the pre-petition equity holders here had a far superior — in fact, the *only* — opportunity to bid for the equity. As another "mathematically" oriented commentary correctly concluded, "Exclusivity is inconsistent with new value principles. * * * [T]he debtor's monopoly power also creates economic inefficiency." Michael H. Strub, Jr., *Competition, Bargaining, and Exclusivity Under the New Value Rule: Applying the Single-Asset Paradigm of* Bonner Mall, 111 BANKING L.J. 228, 257 (1994); see also *id.* at 246-256 (generally correct mathematical analysis of new value exception).

According to Professor Markell, "new value cases and the absolute priority rule yield the same result," because both require that all of the debtor's "reorganization value" go to senior creditors. Markell Br. 23-24; see also Resp. Br. 30 & n.34. If they are "the same" in reality, one wonders why litigants have been fighting about this issue for more than a decade.

In any event, the legal flaws in the argument are apparent. First, the absolute priority rule does not mandate simply that senior creditors receive "reorganization value"; it requires that a senior dissenting class of creditors "'*must be provided for in full* before any junior class can receive or retain any property.'" *Ahlers*, 485 U.S. at 202 (emphasis added).[12] Second, Professor Markell seems to assume that the entity to which the old owners are contributing new capital has no value. See Markell Br. 24. But this Court held in *Ahlers* that even entities that are "worthless" in a balance-sheet sense may have some value. 485 U.S. at 208 ("there may be some value in the control of the enterprise"). Prior equity holders will *choose* to contribute new value only if they will be obtaining an interest that they believe — for whatever reason (see note 19, *infra*) — to be worth more than the amount of the contribution. See John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 MICH. L. REV. 963, 1012-1016 (1989); DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 262-263 (1993).

7. The debtor and its amici offer no direct response to the obvious point (Pet. Br. 25) that, had Congress intended to include a new value exception in Chapter 11 of the Bankruptcy Code, it easily could have done so.[13] Nor do they respond to the observation

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[12] Professor Markell (at 23-24 n.16) criticizes this part of the unanimous decision in *Ahlers* as an "overstate[ment]" that is "contrary" to prior cases and "has far-reaching and pernicious implications." In fact, the quoted statement in *Ahlers* is strikingly similar to a statement in H.R. Rep. No. 95-595, at 413: "if the class is impaired, then they must be paid in full or, if paid less than in full, then no class junior may receive anything under the plan." The debtor also dismisses as an "oversimplifi[ed]" "slogan[ ]" that is "patently inconsistent with the plain language of the Code" (Resp. Br. 3 & n.5) the statement in *Ahlers* that whether creditors would be "better off if [the] reorganization plan was confirmed" is a "determination * * * for the creditors to make" and for the judiciary to "effectuate." 485 U.S. at 207. We submit that the unanimous *Ahlers* decision was correct.

[13] They likewise offer no rejoinder to the point (Pet. Br. 25 n.14) that Congress provided no guidance regarding the content of any new value exception, and

of amici that, since the enactment of the Code in 1978, Congress has included exceptions along those lines in two other chapters of the Bankruptcy Code. See ABA/CBA Br. 12-13 (citing 11 U.S.C. §§ 1225(b)(1)(B), 1325(b)(1)(B)). At the time of these subsequent statutory enactments, Congress made no similar changes to Section 1129(b)(2)(B)(ii). Moreover, even at the time of the Code's enactment, Congress knew how to use the phrase "new value" when it wanted to. 11 U.S.C. § 547(a)(2), (c)(1), (c)(3), (c)(4).

II. THE LEGISLATIVE HISTORY DOES NOT SUPPORT ADOPTION OF A NEW VALUE EXCEPTION

The briefs of the debtor and its amici are conspicuously silent with respect to key passages in the 1978 legislative history: unequivocal statements that the absolute priority rule adopted by Congress means that junior interests cannot receive *anything* until senior creditors are *paid in full*. See Pet. Br. 28-31; U.S. Br. 17-18. Nor do those briefs attempt to square their interpretation of the statute — that Congress incorporated *in toto* case law at least 40 years old concerning the meaning of "fair and equitable" — with the House Report's discussion of Section 1129(b)(2). The report described the statute as a "*partial* codification of the absolute priority rule," H.R. Rep. No. 95-595, at 414 (emphasis added), explaining that, "if the class is impaired, then they must be paid in full or, if paid less than in full, then no class junior may receive *anything* under the plan." *Id.* at 413 (emphasis added); see also *id.* at 224 ("The bill defines 'fairly' in terms of the relative rights among the classes. * * * The rule is a *partial* application of the absolute priority rule now applied under Chapter X.") (emphasis added).

Instead, the debtor and its amici emphasize a rejected 1973 proposal that would have permitted new value plans like that overturned in *Ahlers*. Resp. Br. 37-38; Org. Br. 20; Markell Br. 15-16. As we have already explained (Pet. Br. 27-28), this tells us little about the far different statute — with no provision for a new value exception — that Congress enacted five years later. The legislative history of *that* statute indicates plainly that Congress intended to adopt, with respect to a dissenting class of unsecured claims against an insolvent debtor, an unqualified absolute priority rule that is irreconcilable with a new value exception.

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that its failure to do so reinforces the conclusion that it intended the codified absolute priority rule to be enforced as written, not to be subject to an exception — uncodified and unmentioned in the legislative history — developed by the courts.

III. CONGRESS DID NOT TACITLY ADOPT A NEW VALUE EXCEPTION IN 1978

Although the statute does not include a new value exception and the legislative history describes the absolute priority rule in terms that preclude any such exception, the debtor and its amici argue that Congress must have adopted a new value rule. The argument rests on two pillars: (1) before 1978 "fair and equitable" were words of art in the bankruptcy world that this Court had construed since 1869 to include new value concepts; and (2) Congress, although silent on the matter, meant to incorporate that prior construction into the Code. We begin with the latter point.

1. It is always hazardous to try to divine Congress's intent when Congress has not spoken. But that is not what we have here. Congress *has* spoken. It completely overhauled the law of bankruptcy (Pet. Br. 37-40; U.S. Br. 26-30) — a sea change barely acknowledged in the briefs of the debtor and its amici. In Section 1129(b)(2), Congress adopted a detailed definition of "fair and equitable" that did not exist in pre-1978 bankruptcy law. Moreover, in doing so, the House Report explained that "[t]he elements of the test *are new*[,] *departing from both the absolute priority rule* and the best interests of creditors tests found under the Bankruptcy Act." H.R. Rep. No. 95-595, at 414 (emphasis added). And as noted, the House Report also described Section 1129(b)(2) as a *partial* codification of the absolute priority rule and summarized the absolute priority rule in unequivocal terms that did not leave any room for a new value exception. The language and structure of the Code alone are compelling evidence that Congress did not adopt pre-Code law on this point. When the statutory text is considered in conjunction with the House Report, the conclusion that Congress intended to depart from pre-Code law here is inescapable.

The treatment of "give up" plans under the Code is further confirmation that Congress decided *not* to adopt pre-1978 case law construing "fair and equitable." As the Solicitor General has explained (at 22), Congress squarely rejected a Senate proposal that would have permitted plans in which senior creditors gave up part of their own claims to junior creditors, without the consent of an impaired intermediate class of creditors. See also Prof. Br. 14-15; H.R. Rep. No. 95-595, at 416 (Section 1129(b)(2) "is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is

unimpaired. This gives intermediate creditors a great deal of leverage in negotiating with senior or secured creditors who wish to have a plan that gives value to equity.").[14] "Give up" plans were, however, permitted under this Court's iteration of the "fair and equitable" test in *Kansas City Terminal Ry.* v. *Central Union Trust Co.*, 271 U.S. 445 (1926), the principal authority on which the dicta in *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), were based. See Pet. Br. 34; BAIRD, *supra*, at 261-262. Thus, the contention that "[t]he Code made no change to the substance of the 'fair and equitable' rule * * * as interpreted in *Kansas City Terminal*" (Resp. Br. 11) is dead wrong — the Code effectively **overruled** *Kansas City Terminal*'s interpretation.

The new statutory definition of "fair and equitable" and Congress's rejection of the use of "give up" plans both refute the contention (Resp. Br. 39) that "the Code merely changed the identity of the party who possessed standing to invoke the absolute priority rule" with "no effect on the substance" of the rule. And changing the absolute priority rule so that it could be invoked by a dissenting class, but not by a "gadfly creditor" (U.S. Br. 27), *is* a fundamental change in the substance of the rule — particularly when combined with the Code's reallocation of bargaining power between creditors and debtors and the Code's dramatic reduction in the role of the independent trustee. See *id.* at 26-29; Pet. Br. 38-40.

2. It is not true that this Court has "always" indicated that new value principles are "part of the 'fair and equitable' concept." Markell Br. 3; see also Resp. Br. 29-34 (arguing that the new value "corollary" has been "established" since 1869); Org. Br. 6 ("the new value principle was not '*dicta*' prior to the Code[ ]"). In *Ahlers*, this Court referred to the new value discussion in *Case* as "dicta." 485 U.S. at 203. Professors Markell and Klee reached the same conclusion in academic articles. See Markell, *supra*, 44 STAN. L. REV. at 90, 92 (explaining that the new value exception is found in "[a] distinct line of cases tracing back to *Case*" and that before 1978 "no reported case seems to have adopted Justice Douglas' dicta as its holding"); Klee, *supra*, 64 AM. BANKR. L.J. at 241 ("no reported decision appears to exist under the Bankruptcy

[14] The "give up" plan in *In re Resorts Int'l, Inc.*, 145 B.R. 412 (Bankr. D.N.J. 1990) (see Org. Br. 28 & n.14), should not have been confirmed. The statutory text and the legislative history discussed above make clear that that plan violated Section 1129(b).

Act in which the exception applied"). As those articles indicate, this Court has never upheld a plan of reorganization based on a new value exception. See also Ayer, *supra*, 87 MICH. L. REV. at 969-979, 999-1007, 1015-1016; Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. REV. 975, 987-1002 (1997) (both discussing the history of the absolute priority rule and the origins of the new value exception); U.S. Br. 24-25; Pet. Br. 33.[15]

3. Lower court cases are irrelevant to the question whether the Code implicitly incorporates the new value exception. See *Ahlers*, 485 U.S. at 205 ("the statutory language and the legislative history of § 1129(b) clearly bar any expansion of any exception to the absolute priority rule beyond that recognized *in our cases* at the time Congress enacted the 1978 Bankruptcy Code") (emphasis added). In any event, as *all* the articles just cited conclude, *no* reported lower court decision between 1939 and 1978 transforms the *Case* dicta into a holding; none of the cases cited by our opponents involved new value plans in which equity holders participated over senior creditors' objections. See Resp. Br. 34 n.40; Org. Br. 16-17; Markell Br. 14. In short, unlike *Midlantic Nat'l Bank* v. *New*

[15] The government's brief in *Case*, arguing in favor of the *creditors* there, hardly supports the debtor's position. Most obviously, of course, the pertinent statutory language has changed completely since then. In addition, that brief's discussion of new value (at 40-50) is based on *Kansas City Terminal*, which was overruled by the Code, and *Northern Pac. Ry.* v. *Boyd*, 228 U.S. 482 (1913), which held that the absolute priority rule *precluded* stockholders from retaining their prior ownership interests without providing first for unsecured creditors. In fact, the *Case* brief argues (at 14-15) that the new value "corollary * * * has been perverted into a device for depriving senior interests of the property values which this Court has held them entitled to retain." See also, *e.g.*, *id.* at 23-24 ("A plan of reorganization which fails to give precedence to the entire claim of senior creditors before permitting participation by junior creditors or stockholders is not fair and equitable as a matter of law.").

The pre-*Boyd* cases that the debtor cites do not support its position either. The Court held in *Chicago R.I. & P.R.R.* v. *Howard*, 74 U.S. 392, 411 (1868), a case involving the distribution of the proceeds from the sale of an insolvent railroad, that unsecured creditors should take ahead of shareholders. *Louisville Trust Co.* v. *Louisville, N.A. & C. Ry.*, 174 U.S. 674, 684 (1899), reversed a foreclosure decree that did not provide for unsecured creditors and reaffirmed the "familiar rule" that "the stockholder's interest in the property is subordinate to the rights of creditors." Neither case involved an infusion of new capital by existing shareholders. See generally Miller, *supra*, 77 B.U. L. REV. at 987-990.

Jersey Dep't of Envt'l Protec., 474 U.S. 494 (1986), this case involves *no* pre-Code holdings on the issue at hand.

IV. THE POLICY ARGUMENTS ADVANCED BY THE DEBTOR AND ITS AMICI DO NOT SUPPORT CREATION OF A NEW VALUE EXCEPTION

The debtor and its amici proffer a potpourri of policy reasons why the Court should adopt a new value exception. Those arguments are unpersuasive.

1. NACM argues (at 12-14) that a new value exception is needed because small businesses may have trouble finding other financing. That concern is misdirected because, again, our position does *not* in any way suggest that prior equity holders are *prohibited* from participating in reorganizations or from contributing new value. We contend only that they must either obtain creditor *consent* to a plan that involves such a contribution or comply with the absolute priority rule. In any event, NACM's concern is overstated. Many businesses are able to obtain new funding, convince creditors to agree to plans that would otherwise violate the absolute priority rule, or reach some other accommodation with their lenders. See Pet. Br. 48-49; Prof. Br. 24-25. To the extent that some debtors are unable to achieve any of those alternatives, that is undoubtedly a reflection of the fact that most Chapter 11 reorganizations fail and many Chapter 11 plans, as here, are proposed for reasons unrelated to the firm's ongoing business prospects. It makes little sense to create a new value exception that will serve, in most cases, simply to delay the inevitable. As a study cited by NACM concludes, most Chapter 11 businesses (particularly small businesses) ultimately fail, and thus "the interests of creditors in the assets of an insolvent business must be paramount." Lynn M. LoPucki, *The Debtor in Full Control — Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 99, 100, 247, 258-259, 273 (1983); see also *Associates Commer. Corp.* v. *Rash*, 117 S. Ct. 1879, 1885 (1997) (the "'vast majority of reorganizations fail'"); Pet. Br. 49.

2. The notion that creditors would rather be undersecured than fully secured (see NACM Br. 22) is bizarre. Fully secured creditors stand to be paid in full while undersecured creditors rarely are, and fully secured creditors will be entitled to the accrual and ultimate payment of post-petition interest, while undersecured creditors will not be. 11 U.S.C. § 506(b); *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988); *In re*

Delta Resources, Inc., 54 F.3d 722, 727 (11th Cir. 1995). Creditors seldom will forgo these valuable economic rights for the purpose of possibly increasing their negotiating leverage as undersecured creditors.

3. We do not contend that bankruptcy judges "should be prohibited from ever making valuation decisions." Resp. Br. 48. The Code sometimes requires that judges make valuation decisions. But the Code also minimizes the instances in which they are necessary, a reflection of Congress's expressed conviction that "a valuation is usually 'a guess compounded by an estimate'" and that, "[t]hough valuation is theoretically * * * precise," it is "more often" used to "fudg[e] a result that will support the plan that has been proposed." H.R. Rep. No. 95-595, at 222. Valuation is an essential component of any new value exception and, in practice, a new value exception will frequently result in a decision by old equity holders to contribute new capital *only* if they believe that the judge has undervalued the firm and that they will thus benefit, at the expense of unpaid creditors. See Pet. Br. 45; BAIRD, *supra*, at 262-263. "This is not an objection based on the notion that bankruptcy judges are bad at valuing firms"; rather, it is based on the reality that, "[i]n operation, the new value exception is going to systematically favor the shareholders at the creditors' expense." *Id.* at 263.

4. NACM claims (at 23) that without the new value exception "unsecured creditors will get nothing unless the debtor has unencumbered assets or is solvent." That is not necessarily so given the dynamics of negotiation, as NACM inadvertently concedes (at 23 n.16). Even if it were so, however, it would be no reason to inject a new value exception into the Code. Giving more junior classes "nothing" unless more senior classes are paid in full is the *purpose* of the absolute priority rule. *Ahlers*, 485 U.S. at 202; *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1359 (7th Cir. 1990) ("Priority is 'absolute' in the sense that every cent of each class comes ahead of the first dollar of any junior class."). Hostility to the absolute priority rule enacted by Congress is not a legitimate reason to create an exception to it.

Sympathy for unsecured creditors with small claims (see NACM Br. 24) is an equally invalid method for construing a statute.[16] It is the absolute priority rule, not notions of redistributive

[16] Glossing over the fact that the bank's $38.5 million unsecured claim exceeded the other non-insider unsecured claims (paid in full in cash under the

justice, that "animates the law of corporate reorganizations" and is "central to Chapter 11." BAIRD, *supra*, at 262.

5. NACM also asserts that "Chapter 11 favors debtor rehabilitation over liquidation, so long as the creditors are adequately protected," and speculates that jobs and tax revenue may be lost without reorganization. NACM Br. 3, 5, 9. However,

> no one has presented evidence showing that fewer jobs are lost when a firm reorganizes than when a firm is liquidated. In fact, reorganizations often involve the firing of employees, and liquidations often involve the selling off of entire components of a business without resulting in a substantial loss of employment.

Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47, 53 (1997).

NACM's speculations about the effects of liquidation are especially unwarranted in a single-asset real estate case like this one.[17] If this Court reverses the judgment below and the bank

plan on the effective date) by more than $38.4 million, the debtor criticizes the bank for attempting to use an "artificially created" unsecured claim (Resp. Br. 2) to hold up a plan approved by another class of unsecured creditors. The debtor's real quarrel is with the legislative choices made by Congress. The Code divides the bank's undersecured claim into secured and unsecured claims. 11 U.S.C. § 1111(b). The bank objected to the plan, as it was entitled to, so that its senior claim would have to be provided for in full before the equity holders could receive any property under the plan on account of their pre-petition interests. Moreover, the Seventh Circuit, unlike other circuits, *requires* that unsecured claims like the bank's be placed in a class *separate* from the other unsecured claims. See J. Ronald Trost, et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595, 605-617 (1997) (available on Westlaw). If the majority rule had been followed here and all unsecured claims had been placed in the same class, the bank's votes would have resulted in disapproval of the plan by the entire class, and the plan could not have been confirmed because *no* class of impaired, non-insider creditors would have consented to it. See 11 U.S.C. § 1129(a)(10).

[17] This is the typical context in which new value plans are proposed. 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c][ii][B], at 1129-113 (L. King 15th ed. rev. 1997). Thus, contrary to NACM's suggestion (at 4), most new value plans are proposed in cases in which plan confirmation *is* "a two-party negotiation between a debtor and a creditor." See Strub, *supra*, 111 BANKING L.J. at 256-257. And it is fanciful to hypothesize a new value case in which there is a secured creditor with a $90,000 deficiency and unsecured claims totaling $93 million. NACM Br.

forecloses, the bank will sell the property. The office building will continue to be leased to tenants. No jobs will be lost, and tax revenues will actually rise — the debtor's owners will have to pay the $20 million tax bill they have deferred because they have continued to own the property.

In general, moreover, the bank's position would *not* lead to more liquidations and fewer reorganizations. If the bank's position is accepted, debtors will no longer be able to threaten cramdown of new value plans as an alternative to agreeing with creditors. Faced with the downside risk of a liquidation, which would often deprive *both* debtors and creditors of *any* going-concern surplus, the parties would have a powerful incentive to negotiate to *agreement* on a reorganization plan. Thus, it is likely that accepting the bank's position will lead to an increase in *consensual* reorganizations, and a decrease in *both* liquidations and cramdowns.

Even when liquidation is a patently undesirable outcome, it is still true that the *threat* of liquidation plays a critical role in the scheme Congress enacted. Just as the threat of a nuclear strike may actually promote peaceful coexistence, so too the threat of a liquidation may promote the crafting of a better plan to which all creditors, voting as classes, and the debtor consent. That plan may be better for all concerned because, if a going-concern surplus exists but would be lost in a liquidation, any allocation of that surplus among creditors and the debtor will make all of them better off than liquidation.[18] And the legislative history unequivocally shows that negotiation among the parties, not cramdown by a judge, is how Congress intended any such surplus to be allocated. See Pet. Br. 29-30.

The threat of cramdown, like the threat of liquidation, plays an important role in shaping negotiations. But cramdown, as it

24. This would never happen in the real world, and, if it did, the estate could pay the $90,000 claim in full to prevent the secured creditor from objecting to the plan.

[18] No individual creditor can ever be worse off under a confirmed plan than under liquidation. 11 U.S.C. § 1129(a)(7). In the present case, no going-concern surplus would be lost on liquidation: the bankruptcy judge found that the bank could realize the going-concern value of the property on foreclosure of its mortgage. Pet. App. 117a-118a. In other cases, however, there will be a going-concern surplus that could be lost on liquidation, and the Court may legitimately consider the incentives that the ruling in this case will create in other settings.

appears in the Code, requires adherence to the absolute priority rule. It removes the creditors' legitimate objections *not* by attempting to allocate the going-concern surplus, but by requiring that they be paid *in full* before more junior classes may receive property under the plan. Creating an exception to that rule makes cramdown easier and fundamentally alters the negotiating incentives that the Code provides.

If judges can approve plans that do not honor the absolute priority rule, then the incentives the Code creates for fruitful negotiation are perversely altered. The debtor's insiders will have a sharply diminished incentive to negotiate whenever they have a chance of retaining property with an economic value to them greater than the "new value" they put in,[19] or of accomplishing other business objectives that benefit the equity holders but not the bankruptcy estate or the creditors. That is manifestly what happened here. Retaining rather than losing ownership of the property resulted in an immediate tax benefit of $20 million to the debtor's equity holders; compelled the bank to continue for ten years a business relationship with a "reorganized" debtor that will remain insolvent for the duration of its plan; and provided the bank with an expectation to receive in year ten only 16% of its $38.5 million unsecured claim on a present-value basis. Adding insult to injury, the debtor's plan assumes that the bank will "voluntarily" re-lend $4.5-$5 million by year eight of the plan. See Pet. Br. 7 n.5; Pet. App.153a.

A plan may be confirmed by consent, or by honoring the absolute priority rule. There is no third possibility. In that way parties are given the proper negotiating incentives. The contrary results that the debtor and its amici urge are neither permitted by the Bankruptcy Code nor consistent with sound bankruptcy policy.

CONCLUSION

The judgment of the court of appeals should be reversed.

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[19] In any particular case, the property may have value to the equity holders greater than the value a bankruptcy judge places on it for any of several reasons: because of tax considerations that the judge regards as irrelevant to valuation; because the judge — being human and applying the notoriously inexact "science" of valuation — makes a mistake; because the property appreciates, after the judge values it, in a manner unforeseen by the judge at the time of valuation; or because the ability to control an entity may have value even if the ability is "worthless" in a balance-sheet sense (*Ahlers*, 485 U.S. at 208).

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1998

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Successor by merger to Bank of America Illinois,
PETITIONER

v.

203 NORTH LASALLE STREET PARTNERSHIP,
RESPONDENT

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONER'S SUPPLEMENTAL BRIEF IN RESPONSE TO RESPONDENT'S SUPPLEMENTAL BRIEF

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11pp

TABLE OF AUTHORITIES

Cases **Page**

203 North LaSalle Street Partnership, In re,
126 F.3d 955 (7th Cir. 1998) 1

Bonner Mall Partnership, In re, 2 F.3d 899
(9th Cir. 1993), cert. dismissed,
513 U.S. 18 (1994) 1, 3

Bryson Properties, In re, 961 F.2d 496
(4th Cir. 1992) 1

Cajun Electric Power Cooperative, Inc., In re,
150 F.3d 503 (5th Cir. 1998) 1, 2

Coltex Loop Central Three Partners, L.P., In re,
138 F.3d 39 (2d Cir. 1998) 1

Greystone III Joint Venture, In re, 995 F.2d 1274
(5th Cir. 1992) 1

Norwest Bank Worthington v. *Ahlers*,
485 U.S. 197 (1998) 5, 6

Southeast Banking Corp., In re, No. 97-4436,
1998 WL 663359 (11th Cir. Sept. 28, 1998) 1

Statutes **Page**

11 U.S.C. § 1123(a)(4) 2

11 U.S.C. § 1129(a)(7) 5

11 U.S.C. § 1129(b)(1) 6

11 U.S.C. § 1129(b)(2) 4, 6-7

11 U.S.C. § 1129(b)(2)(B)(ii) 2

Other Authorities **Page**

Brian A. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 COM. L.J. 290 (1996) 4

Randolph J. Haines, *The Unwarranted Attack on New Value*, 72 AM. BANKR. L.J. 301 (1998) 3, 4, 5

H.R. Rep. No. 95-595 (1977) 5, 6

Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69 (1991) 3

Michael H. Strub, Jr., *Competition, Bargaining, and Exclusivity Under the New Value Rule: Applying the Single-Asset Paradigm of Bonner Mall*, 111 BANKING L.J. 228 (1994) 4

PETITIONER'S SUPPLEMENTAL BRIEF IN RESPONSE TO RESPONDENT'S SUPPLEMENTAL BRIEF

Pursuant to Rule 25(5) of the Rules of this Court, petitioner hereby files this supplemental brief for the sole purpose of responding to the supplemental brief of respondent filed on October 14, 1998.

1. Five courts of appeals have decided the exact question presented in this case. Two of those courts of appeals have agreed with respondent's position, and this Court has granted certiorari to review each of those two decisions.[1] The other three courts have agreed with petitioner's position, though a 2-1 majority of the Fifth Circuit subsequently vacated that court's discussion of the issue without explanation.[2] To the extent that this Court looks to decisions of the courts of appeals for persuasive guidance, those five decisions more than sufficiently debate the merits of the precise question this Court granted certiorari to decide.

Respondent contends, however, that this Court should take guidance from a post-*Greystone* Fifth Circuit decision that does *not* present the same issue as this case. *In re Cajun Electric Power Cooperative, Inc.*, 150 F.3d 503 (1998).[3] Neither the debtor nor any other party in *Cajun* proposed to receive or retain an interest in a bankruptcy estate in exchange for a con-

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[1] *In re 203 North LaSalle Street Partnership*, 126 F.3d 955 (7th Cir. 1998) (decision below); *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), cert. dismissed, 513 U.S. 18 (1994).

[2] *In re Coltex Loop Central Three Partners, L.P.*, 138 F.3d 39 (2d Cir. 1998); *In re Bryson Properties*, 961 F.2d 496 (4th Cir. 1992); *In re Greystone III Joint Venture*, 995 F.2d 1274, 1282-1284 (5th Cir. 1991), vacated, 995 F.2d 1284.

[3] If the Court is disposed to look at recent court of appeals decisions that do not present the same issue that is before the Court, more pertinent than *Cajun* is *In re Southeast Banking Corp.*, No. 97-4436, 1998 WL 663359, at *8 & n.16 (11th Cir. Sept. 28, 1998), where the court held that clear statutory language sufficed to demonstrate Congress's intent to depart from pre-Code practice, despite the absence of any legislative history acknowledging the departure.

tribution of "new value" to the estate. Rather, one plan proponent (SWEPCO) made certain direct payments to certain creditors and/or equity holders (members of the Committee of Certain Members, or "CCM") to reimburse them for certain litigation fees and expenses and allegedly to try to help secure their support for a plan of reorganization proposed by SWEPCO. "SWEPCO's payments to the CCM * * * were not made out of the bankruptcy estate's assets." 150 F.3d at 518.

The Fifth Circuit rejected an argument that the payments from SWEPCO to members of the CCM violated either 11 U.S.C. § 1123(a)(4) or 11 U.S.C. § 1129(b)(2)(B)(ii). In the passage that respondent selectively quotes, the court explained its rationale as follows:

> [T]he payments were not made in satisfaction of the CCM members' claims against Cajun, but rather as reimbursement for plan and litigation expenses incurred in the bankruptcy case.

150 F.3d at 518-519. *Cajun* thus stands for the entirely unremarkable proposition that, when a creditor receives money from another participant in the bankruptcy case[4] in exchange for something other than its bankruptcy claim, it is not receiving or retaining property "on account of" its interest in the estate.

Cajun does *not* stand for the proposition that "on account of" means "in satisfaction of." The phrase "in satisfaction of" was merely used to explain the court's rationale, not to define "on account of" for all purposes. Any synonym for "on account of" would have worked equally well to explain the court's reasoning.

[4] We use the ambiguous phrase "another participant in the bankruptcy case" advisedly. The Fifth Circuit's opinion never definitively characterizes SWEPCO as a creditor, a pre-petition equity holder, an interested third party, or anything else. Likewise, the court found it unnecessary to classify the recipients of the payments as creditors or equity holders. 150 F.3d at 515 n.6 ("our decision hinges in no way upon the characterization of the members' various interests as debt or equity-based"). The fact that those questions of classification — which are vitally important in a new-value case — were completely irrelevant to the Fifth Circuit's decision shows how far afield the issue in that case was from the issue in this case.

What *Cajun* does demonstrate, however, is that the phrase "on account of" has many roles to play in separating forbidden reorganization plans such as respondent's from those plans that do not violate the statute. As we observed in our opening brief (at 22 n.12) and reply brief (at 9), one need not invent a new value exception, which can be found nowhere in the Code, to prevent the words "on account of" from being superfluous. Thus, *Cajun* conclusively proves the fallacy of part of the reasoning of one of the two appellate decisions supporting respondent, *Bonner Mall*, 2 F.3d at 909.

2. The Court is welcome to read the forthcoming law review article respondent cites in its supplemental brief, or any of the scores of other law review articles on both sides of the new value debate. We respectfully submit that the more persuasive scholarship is found in the articles and decisions that support petitioner's position in this case, and in the amicus brief filed by nine eminent bankruptcy professors in support of petitioner in this case.[5] Indeed, as our reply brief points out (at 4-5), even the law professors who have filed briefs in support of *respondent* have previously taken the position in academic writings that a plan of reorganization may not lawfully afford pre-petition equity holders — as the plan in this case does — the *exclusive* right to receive new equity interests by contributing "new value." See also Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 114-115 (1991). When all is said and done, there is *no* discernible academic support for a *debtor-only* new value exception, which is what this case involves.

As to the new article, it is written not by a law professor, but by a lawyer in private practice.[6] The article's analysis is

[5] Brief of Ronald Mann, Robert K. Rasmussen, Barry Adler, James Bowers, Daniel L. Keating, Eric A. Posner, Alan Schwartz, David A. Skeel, Jr., and James J. White, as *Amici Curiae* in Support of Petitioner.

[6] Randolph J. Haines, *The Unwarranted Attack on New Value*, 72 AM.

very similar to that of Professor Markell. In particular, it advances the contention that Section 1129(b)(2) provides merely "nonexclusive examples of methods for satisfying the fair and equitable requirement." 72 AM. BANKR. L.J. at 302 n.3.[7] As was shown in our reply brief (at 5 n.7) and opening brief (at 18 n.10), that argument is completely untenable. Section 1129(b)(2) declares that "the condition that a plan be fair and equitable with respect to a class *includes the following requirements*." 11 U.S.C. § 1129(b)(2) (emphasis added). "Requirements" are not mere examples.

Mr. Haines also seems to fail to appreciate that negotiation, not cramdown, is how Congress intended parties to allocate any value that may be available in a reorganization but not in a liquidation. See Pet. Br. 29-30; Reply Br. 19. Mr. Haines writes:

> [*203 North LaSalle*] does not raise the concern that new value proposals are inherently illogical economically. Given the tax consequences to the limited partners, the apartment [*sic*] project inherently had a value $20 million greater to them than to anyone else. Assuming the $55.8 million fair market value as found by the court, it would have something closer to a $75 million value to the partners. Under those circumstances, it makes perfect economic sense for the owners and the bank to split the valuation difference, by the owners contributing new value that provides the creditor a greater value than it would receive upon foreclosure, but that still justifies the partners' investment of new money.

BANKR. L.J. 301 (1998). Mr. Haines is a member of Lewis and Roca, Phoenix, Arizona. *Id.* at 301 n.*. For persuasive articles by lawyers in private practice taking contrary positions, see, *e.g.*, Brian A. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 COM. L.J. 290 (1996), and Michael H. Strub, Jr., *Competition, Bargaining, and Exclusivity Under the New Value Rule: Applying the Single-Asset Paradigm of* Bonner Mall, 111 BANKING L.J. 228 (1994).

[7] See also 72 AM. BANKR. L.J. at 332 & n.167; Markell Br. 2, 21; Resp. Supp. Br. 3 & n.4.

72 AM. BANKR. L.J. at 309 (footnotes omitted). Mr. Haines seems to suggest that the opportunity to make the debtor and creditors alike better off through a plan of reorganization justifies judicial intrusion, but Congress had a different view. See H.R. Rep. No. 95-595, at 224 (1977) ("It is unrealistic to assume that the bill could or even should attempt to answer that question. Instead, negotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders.").

Furthermore, Mr. Haines seems to believe that the bank should have no quarrel with any plan that leaves the bank better off than a liquidation.[8] But, as we pointed out in the reply brief (at 9-10), such an approach makes the absolute priority rule redundant with the "best interests" test of 11 U.S.C. § 1129(a)(7), which requires any plan to provide all creditors with at least as much as they will receive in a liquidation. And Mr. Haines's approach invites the Court to substitute its judgment for that of the creditors about what is in their best interests. But this Court has already rejected that approach. *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 207 (1988) (whether creditors would be "better off if [the] reorganization plan was confirmed" is a "determination * * * for the creditors to make" and for the judiciary to "effectuate").

3. We stand by the discussion of the legislative history, including the House Report on the 1977 bill, in our opening and

[8] Mr. Haines asserts that the bank has no significant quarrel with the bankruptcy court's valuation of the property and that, thus, the bank had no legitimate basis for opposing the plan. 72 AM. BANKR. L.J. at 305 n.29, 353 n.249, 359-360. (Indeed, he makes the wholly unsubstantiated — and false — claim that the bank sought to foreclose at a value below what the plan promised it. *Id.* at 359.) This overlooks not only the bank's position relating to valuation repeatedly set out in its briefs (see Pet. Br. 5 n.2, 41-42, 42 n.24; Reply Br. 17, 20), but also the other features of the plan that would make it unacceptable to any creditor such as the plan's assumption that the bank will "voluntarily" re-lend $4.5-$5 million by year eight of the plan. See Pet. Br. 7 n.5; Pet. App. 153a; Reply Br. 20.

reply briefs.[9] Contrary to respondent's claim, the 1978 legislation did not differ in a material way from the 1977 bill on which the House Report comments.

As is reflected in the appendix to respondent's supplemental brief, Section 1129(b)(2)(B), as it would have been enacted by the 1977 bill, would have provided that a plan could not be crammed down on impaired, dissenting, unsecured creditors unless, among other things,

> (iii) each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim, unless such holder has agreed to a different treatment of such claim; or
>
> (iv) the plan does not discriminate unfairly against such class, and the holders of claims or interests o[r] any class of claims or interests, as the case may be, that is junior to such class *will not receive or retain under the plan on account of such junior claims or interests any property* * * *. [Emphasis added.]

In the statute that was enacted, Congress included *the exact same requirement*. Although Congress chose to include the relevant language as part of the definition of "fair and equitable," it made no substantive change. Section 1129(b)(1) as enacted requires that *every* crammed-down plan be "fair and equitable," and Section 1129(b)(2) defines "fair and equitable." According to Section 1129(b)(2),

> For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class *includes the following requirements*:
>
> * * * * *
>
> (B) With respect to a class of unsecured claims —

[9] H.R. Rep. No. 95-595 (1977). The report was quoted in *Ahlers*, 485 U.S. at 208, and in more than half-a-dozen places in our opening brief. Reliance on the report hardly started with our reply brief.

> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class *will not receive or retain under the plan on account of such junior claim or interest any property*.

11 U.S.C. § 1129(b)(2) (emphasis added).

As is readily apparent, the statute as enacted contains, insofar as relevant, the *exact same substantive requirement in almost the exact same words* as the 1977 bill. To try to escape the force of the 1977 House Report by pointing to the minor reorganization of the statute's terms, therefore, is entirely disingenuous.

Respondent insists (at 4) that "fair and equitable" is a "term of art" and that Congress "inten[ded] to carry forward into the Code through the 'fair and equitable' requirement the new value principles which this Court long ago recognized." If so, then, as we observed in our reply brief (at 1 n.1), we are at a loss to understand why Congress saw fit to define "fair and equitable" in the statute, and to do so without any mention of a new value exception. And Congress *did* define "fair and equitable," as the language just quoted from Section 1129(b)(2) makes clear.[10] Respondent's claim that "Congress did not adopt 'a detailed definition of fair and equitable'" (Resp. Supp. Br. 4) is pure wishful thinking.

For the foregoing reasons and those stated in our opening and reply briefs, the judgment of the court of appeals should be reversed.

[10] The use of the phrase "includes the following requirements" shows that the definition is not *comprehensive*. But it is hard to see how anyone could seriously deny that the statutory definition of "fair and equitable," set forth in eight subparagraphs, is detailed, or that it is a definition.

Respectfully submitted.

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In The

Supreme Court of the United States

October Term, 1998

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, SUCCESSOR BY MERGER TO BANK OF AMERICA ILLINOIS,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

SUPPLEMENTAL BRIEF OF RESPONDENT

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SUPPLEMENTAL BRIEF OF RESPONDENT

Respondent, 203 North LaSalle Street Partnership, submits this Supplemental Brief in order to bring to the Court's attention late authorities and other intervening matter that was not available in time to be included in Respondent's Brief on the merits, pursuant to Rule 25(5) of the Supreme Court Rules.

I. Late Authority Supporting Respondent.

A. Fifth Circuit Authority.

Respondent filed its Brief on the merits on August 17, 1998. Thereafter, Respondent learned of *Matter of Cajun Electric Power Co-op, Inc.*, 150 F.3d 503 (5th Cir. 1998).[1] This decision supports Respondent's argument, contained at pages 12-14 of the Brief for Respondent, that "on account of" in 11 U.S.C. § 1129(b)(2)(B)(ii) means "in satisfaction of". In that case, the Fifth Circuit held that a plan proponent's payment to reimburse the legal fees of certain entities who were both creditors and equity interest holders in the debtor did not violate Section 1129(b)(2)(B)(ii). Specifically, the Court held that such payments were not made "on account of [the CCM members'] [unsecured] claim[s] or [their equity] interest[s]" because the payments were not made "in satisfaction of" those claims or interests. *Id.* at 518-519.

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[1] While the opinion is dated August 11, 1998, it was subsequently revised on August 26, 1998 and did not come to counsel's attention until after August 17, 1998. The opinion is reported in the paper volume of West's Federal Reporter, Third Series, dated September 14, 1998.

B. Other Authority

For a comprehensive analysis of the issues of this case, Respondent respectfully directs the Court's attention to Randolph J. Haines, *The Unwarranted Attack On New Value*, 72 Am. Bankr. L.J., at pages 301-368 (1998) (To be published by October 31, 1998).

II. Misstatement of Legislative History in the Reply Brief.

This Supplemental Brief was not written to answer arguments in the Reply Brief for the Petitioner. The Bank's misstatement of the text and legislative history of Section 1129(b) in the Reply Brief creates such a severe misimpression that we are obligated to correct it.

At page 13 of the Reply Brief, Petitioner quotes from a House Report on an early version of Section 1129(b) which was never enacted.[2] That version, reported to the full House on September 8, 1977 (the "1977 Bill"), was materially different from Section 1129(b) as finally

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[2] The Reply Brief states:

> In Section 1129(b)(2), Congress adopted a detailed definition of "fair and equitable" that did not exist in pre-1978 bankruptcy law. Moreover, in doing so, the House Report explained that "[t]he elements of the test *are new*[,] *departing from both the absolute priority rule* and the best interests of creditors tests found under the Bankruptcy Act." H.R. Rep. No. 95-595, at 414 (emphasis added). . . . When the statutory text is considered in conjunction with the House Report, the conclusion that Congress intended to depart from pre-Code law here is inescapable.

enacted (the "Code Section").[3] Specifically, the text of Section 1129(b), as it was proposed in the 1977 Bill, does not contain the words "fair and equitable" – the Code Section does. Nor does the 1977 Bill, as contrasted with the Code Section, use the word "includes," to introduce the various subparagraphs setting forth the minimum standards for confirming a plan over the dissent of various classes of creditors and interest holders.[4]

Congress treated the floor statements of Representative Edwards and Senator DeConcini regarding the Code Section as having the effect of a conference report. 124 Cong. Rec. 32,376 (Oct. 5, 1978). See *Begier v. IRS*, 496 U.S. 53, 64 n.5 (1990). Unlike the House Report quoted in the Reply Brief, these floor statements conspicuously do not say that Section 1129(b) "depart[s] from both the absolute priority and the best interests of creditors tests" – the language quoted (with emphasis added) by Petitioner from H.R. 95-595 (the report on the 1977 Bill). With respect to the text of the Code Section, Representative Edwards stated:

> Paragraph (1) makes clear that this alternative confirmation standard, referred to as 'cramdown,' will be called into play only on the request of the proponent of the plan. Under this cramdown test, the court must confirm the plan if the plan does not discriminate unfairly, and is 'fair and equitable,' with respect to each class of

---

[3] The text of the 1977 Bill is attached as Supplemental Appendix.

[4] "Includes" is specifically defined by 11 U.S.C. § 102(3) as "not limiting."

> claims or interests that is impaired under, and has not accepted, the plan. . . .
>
> Although many of the factors interpreting 'fair and equitable' are specified in paragraph (2), others, *which were explicated in the description of section 1129(b) in the House report* [the report quoted by Petitioner] *were omitted from the House amendment* to avoid statutory complexity and because they would undoubtedly be found by a court to be fundamental to 'fair and equitable' treatment of a dissenting class.

(emphasis added). 124 Cong. Rec. 34,006 (October. 5, 1978) (statement of Rep. Edwards). Thus, contrary to Petitioner's representation, Congress did not adopt "a detailed definition of 'fair and equitable'."

By failing to mention that both the statutory text and the legislative history referred to at page 13 of Petitioner's Reply Brief differ in significant and material ways from both the Code Section and its legislative history, Petitioner creates a serious misimpression regarding the meaning of the Code Section and Congress' intent to carry forward into the Code through the "fair and equitable" requirement the new value principles which the Court long ago recognized as being part of that term of art.

Respectfully submitted,

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Union Calendar No. 311

95TH CONGRESS
1st SESSON

H. R. 8200

[Report No. 95-595]

IN THE HOUSE OF REPRESENTATIVES

JULY 11, 1977

Mr. EDWARDS of California (for himself, Mr. BUTLER, Mr. SEIBERLING, Mr. DRINAN, Mr. VOLKMER, Mr. BEILENSON, and Mr. MCCLORY) introduced the following bill; which was referred to the Committee on the Judiciary

SEPTEMBER 8, 1977

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

(Strike out all after the enacting clause and insert the part printed in italic)

A BILL

To establish a uniform Law on the subject of Bankruptcies.

* * *

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this chapter.

(2) The proponent of the plan complies with the applicable provisions of this chapter.

(3) The proponent of the plan has proposed the plan in good faith, and not by any means forbidden by law.

(4)(A) Any payment made or promised by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in, or in connection with, the case, or in connection with the plan and incident to the case, has been disclosed to the court; and

(B)(i) any such payment made before confirmation of the plan is reasonable; or

(ii) if such payment is to be fixed after confirmation of the plan, such payment is subject to the approval of the court as reasonable.

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy.

(B) The proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation of such insider.

(6) Any regulatory commission with jurisdiction, after confirmation of the plan, over the rules of

the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each class, each holder of a claim or interest of such class –

(A) has accepted the plan; or

(B) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date.

(8) With respect to each class –

(A) such class has accepted the plan; or

(B) the claims or interests of such class are unimpaired under the plan.

(9) The plan provides that each holder of a claim of a kind specified in section 507 of this title will receive on account of such claim, property, other than a security of the debtor, an affiliate participating in a joint plan with the debtor, or a successor to the debtor under the plan, of a value, as of the effective date of the plan, equal to the allowed amount of such claim, except to the extent that the holder of a particular claim of such kind has agreed to a different settlement of such claim.

(10) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(b) Notwithstanding section 510(a)(1) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of such plan, shall confirm such plan notwithstanding the requirements of such paragraph if –

(1) with respect to each class of secured claims –

(A) each holder of a claim of such class will not receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, greater than the allowed amount of such claim; and

(B)(i) such class has accepted the plan;

(ii) the claims of such class are unimpaired; or

(iii) each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value as of the effective date of the plan, equal to the allowed amount of such claim, unless such holder has agreed to a different treatment of such claim;

(2) with respect to each class of unsecured claims –

(A) each holder of a claim of such class will not receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, greater than the allowed amount of such claim; and

(B)(i) such class has accepted the plan;

(ii) the claims of such class are unimpaired;

(iii) each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of

the plan, equal to the allowed amount of such claim, unless such holder has agreed to a different treatment of such claim; or

(iv) the plan does not discriminate unfairly against such class, and the holders of claims or interests of any class of claims or interests, as the case may be, that is junior to such class will not receive or retain under the plan on account of such junior claims or interests any property; and

(3) with respect to each class of equity securities –

(A) if, under the terms of such equity securities, the holders of the interests of such class are entitled to a fixed liquidation preference, or the debtor may redeem such equity securities at a fixed price, then each such holder will not receive or retain under the plan on account of such interest property of a value, as of the effective date of the plan, greater than the greater of –

(i) the amount of any such liquidation preference; and

(ii) the amount of any such fixed price; and

(B)(i) such class has accepted the plan;

(ii) the interests of such class are unimpaired;

(iii) if, under the terms of such equity securities, the holders of such interests are entitled to a fixed liquidation preference, or the debtor may redeem such equity securities at a fixed price, then each such holder will receive or retain under the plan on account of such interest property of a value, as of the effective date of the plan, equal to the greater of the amount of

any such liquidation preference and the amount of any such fixed price;

(iv) the holders of any interests that are junior to the interests of such class will not receive or retain under the plan on account of such junior interests any property; or

(v) there are not any interests junior to the interests of such class.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 11.27(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of section 5 of the Securities Act of 1933 (15 U.S.C. 77e).

* * *

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In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, PETITIONER

v.

203 NORTH LASALLE STREET PARTNERSHIP

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Under Chapter 11 of the Bankruptcy Code of 1978, 11 U.S.C. 1101 *et seq.*, a debtor's plan of reorganization can be imposed over the dissent of some creditors if the plan meets certain criteria. One such requirement is the "absolute priority rule," which provides that, unless and until unsecured creditors are paid in full, "the holder of any claim or interest that is junior to the claims of such class [of unsecured creditors] will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. 1129(b)(2)(B)(ii). The question presented in this case is:

Whether a plan of reorganization that grants the debtor's equity owners an exclusive opportunity to retain or purchase an ownership interest in the reorganized debtor, without first paying a senior, objecting class of unsecured creditors in full, violates the absolute priority rule.

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statement	2
Summary of Argument	7
Argument:	
Section 1129(b) of the Bankruptcy Code bars confirmation of a reorganization plan that permits the debtor's equity owners to retain or acquire property over the objection of a senior, unpaid creditor class	9
A. The plain language of the absolute priority rule admits of no new value exception	10
B. The legislative history recognizes no new value exception to the absolute priority rule	16
C. Rejection of a new value exception is consistent with pre-Code practice	23
Conclusion	30
Appendix	1a

TABLE OF AUTHORITIES

Cases:

A.V.B.I., Inc., In re, 143 B.R. 738 (Bankr. C.D. Cal. 1992)	11, 29
Bonner Mall Partnership, In re, 2 F.3d 899 (9th Cir. 1993), cert. dismissed, 513 U.S. 18 (1994)	10, 12-13, 15, 21
Bryson Properties, XVIII, In re, 961 F.2d 496 (4th Cir.), cert. denied, 506 U.S. 866 (1992)	10
Case v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939)	6, 17, 23, 24, 26
Cohen v. *De La Cruz*, 118 S. Ct. 1212 (1998)	11, 14
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Cases—Continued: Page

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Gozlon-Peretz v. *United States*, 498 U.S. 395 (1991) 11
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INS v. *Cardoza-Fonseca*, 480 U.S. 421 (1987) 21
John Hancock Mutual Life Ins. Co. v. *Harris Trust & Sav. Bank*, 510 U.S. 86 (1993) 22
Kansas City Terminal Ry. v. *Central Union Trust Co.*, 271 U.S. 445 (1926) 22, 23
Kawaauhau v. *Geiger*, 118 S. Ct. 974 (1998) 13
Kelly v. *Robinson*, 479 U.S. 36 (1986) 24
Kham & Nate's Shoes No. 2, Inc. v. *First Bank*, 908 F.2d 1351 (7th Cir. 1990) 4, 10, 27, 28
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Marine Harbor Properties v. *Manufacturer's Trust Co.*, 317 U.S. 78 (1942) 24
Mason v. *Paradise Irrigation Dist.*, 326 U.S. 536 (1946) 24, 25, 26
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Northern Pacific Ry. v. *Boyd*, 228 U.S. 482 (1913) 16
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Phillips v. *Martin Marietta Corp.*, 400 U.S. 542 (1971)..... 14
Phillips v. *Washington Legal Found.*, No. 96-1578 (June 15, 1998) 10

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Railroad Co. v. *Howard*, 74 U.S. (7 Wall.) 392 (1869) 16
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Smith v. *United States*, 508 U.S. 223 (1993) 13, 14, 15
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Toibb v. *Radloff*, 501 U.S. 157 (1991) 12
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Union Bank v. *Wolas*, 502 U.S. 151 (1991) 16, 26, 28
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Ch. VIII, 11 U.S.C. 205 (1970) 16
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Ch. X, 11 U.S.C. 501-676 (1970) 16, 17, 25, 26, 29
11 U.S.C. 621 (1970) 16
Ch. XI, 11 U.S.C. 701-799 (1970) 16, 25
Ch. XII, 11 U.S.C. 801-926 (1970) 16
Bankruptcy Code of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 11 U.S.C. 101 *et seq.*:
Ch. 3, 11 U.S.C. 362 5
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11 U.S.C. 506(a) 3, 5
11 U.S.C. 547(a)(2) 11
11 U.S.C. 547(b)(2) 12
11 U.S.C. 547(c) 11

Statutes—Continued: Page

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Ch. 7, 11 U.S.C. 701 *et seq.* 3
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11 U.S.C. 1121(b) 3
11 U.S.C. 1121(d) 3
11 U.S.C. 1122(a) 3
11 U.S.C. 1124 3
11 U.S.C. 1126(c) 3, 6, 26
11 U.S.C. 1129 ..... 3, 7, 11, 14, 15, 17, 26, 1a
11 U.S.C. 1129(a) 3, 4, 26, 1a
11 U.S.C. 1129(a)(7)(A) 3, 2a
11 U.S.C. 1129(a)(7)(A)(ii) 12, 2a
11 U.S.C. 1129(a)(7)(B) 12, 2a
11 U.S.C. 1129(a)(8) 3, 4, 26, 2a
11 U.S.C. 1129(a)(9)(A) 12, 3a
11 U.S.C. 1129(a)(9)(C) 12, 3a
11 U.S.C. 1129(a)(10) 3, 6, 4a
11 U.S.C. 1129(b) 4, 7, 4a
11 U.S.C. 1129(b)(1) 4, 26-27, 4a
11 U.S.C. 1129(b)(2) 4, 5a
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11 U.S.C. 1129(2)(C)(ii) 12, 6a
Ch. 12, 11 U.S.C. 1201 *et seq.* 11
11 U.S.C. 1225 11
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Vol. B 19
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S. 236, 94th Cong., 1st Sess. (1975) 19

Miscellaneous—Continued: Page

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

The United States appears as a creditor in approximately 12,000 to 15,000 bankruptcy reorganization proceedings a year. A number of federal agencies—including the Department of Housing and Urban Development, the Rural Utility Service, the Maritime Administration, and the Commerce Department's Economic Development Administration—frequently appear as the major creditor in single-asset bankruptcy reorganizations analogous to the case at hand. The Internal Revenue Service appears in approximately 10,000 Chapter 11 cases annually, enforcing governmental claims averaging $1.75 billion in aggregated value. Other federal agencies, such as the Small Business Administration, the Department of Agriculture's Farm Service Agency and Rural Housing Service, and the Federal Deposit Insurance Corporation, also often participate as creditors in bankruptcy proceedings.

This case presents the question whether a Chapter 11 reorganization plan can grant the debtor's equity owners an exclusive opportunity to acquire or retain property in the reorganized debtor before senior, unsecured creditors are paid in full. Such plans of reorganization, by allowing equity holders to acquire or retain property interests while the claims of the United States go unpaid, would impose an unwarranted burden on the public fisc and could adversely affect the operation of important governmental programs, such as the provision of low-income housing. In addition, the perpetuation or extension of loan relationships that such plans frequently entail would require taxpayers, in effect, to subsidize reorganization plans that the federal government has concluded are not in the public interest. Accordingly, the United States has an important stake in the resolution of this case.[1]

STATEMENT

1. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, comprehensively revised bankruptcy law. See *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 238 (1989). As part of this effort, Congress enacted Chapter 11 "with the intention that business reorganizations should be quicker and more efficient and provide greater protection to the debtor, creditors, and the public interest." *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 517 n.1 (1984). The objective of a Chapter 11 proceeding is judicial confirmation of a plan of reorganization that restructures and reschedules the debtor's obligations so that the once-insolvent debtor may emerge as an ongoing concern. See *id.* at 528.[2]

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[1] We also participated in the two cases that previously presented this issue to the Court. U.S. Amic. Br., *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988) (No. 86-958), and *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 513 U.S. 18 (1994) (No. 93-714).

[2] Individuals, as well as businesses, can pursue reorganization under Chapter 11. *Toibb* v. *Radloff*, 501 U.S. 157, 160-166 (1991). Individual Chapter 11 petitions are uncommon, however. Individuals generally prefer Chapter 13's simplified proceedings for rescheduling consumer debt. 11 U.S.C. 1301 *et seq.*

During the first 120 days after a Chapter 11 petition is filed, only the debtor may file a plan. 11 U.S.C. 1121(b). This period of exclusivity may be extended "for cause." 11 U.S.C. 1121(d). The debtor's plan will generally group creditors into classes based on the substantial similarity of their claims. 11 U.S.C. 1122(a). A single creditor may have more than one claim, thus placing it in more than one class. For example, under 11 U.S.C. 506(a), a federal agency that has a loan secured by property may have its claim bifurcated into a secured claim for the appraised value of the property and an unsecured, deficiency claim for the difference remaining between the appraised value and the balance of the loan.

Section 1129 of Chapter 11 sets forth two alternative paths for judicial confirmation of a reorganization plan.[3] First, Section 1129(a) details thirteen requirements for confirmation of a plan based on the consent of the creditor classes. A class of creditors is deemed to have accepted a plan if their claims are unimpaired—that is, they retain all of their pre-petition legal, equitable, and contractual rights against the debtor. See 11 U.S.C. 1124, 1129(a)(8). Alternatively, a class of creditors accepts a plan if a majority of the creditors and two-thirds of the total dollar amount of the claims within that class vote to approve the plan. 11 U.S.C. 1126(c), 1129(a)(8). Such consent plans must be approved by at least one class whose claims are impaired. 11 U.S.C. 1129(a)(10). In addition, each individual creditor who opposes the plan must receive compensation in an amount that is at least equivalent to what would be received in a Chapter 7 liquidation. 11 U.S.C. 1129(a)(7)(A).

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[3] The text of 11 U.S.C. 1129 is reproduced as an appendix to this brief.

The second route to confirmation is commonly known as a "cramdown," because it imposes the plan over the dissent of an impaired creditor class. See *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1359 (7th Cir. 1990). As long as all of the requirements of Section 1129(a) — except, of course, Section 1129(a)(8)'s consent criterion — are satisfied, the objection of an impaired creditor class can be overridden if "the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. 1129(b)(1).

Paragraph (2) of Section 1129(b) sets forth the minimum requirements for a proposed plan of reorganization to be deemed "fair and equitable." Subparagraph (B) provides that, with respect to unsecured claims, a plan is "fair and equitable" only if the allowed value of the claim is paid in full, 11 U.S.C. 1129(b)(2)(B)(i), or if

> the holder of any claim or interest that is junior to the claims of such [impaired, unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. 1129(b)(2)(B)(ii). The latter requirement is known as the "absolute priority rule." See, *e.g.*, *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988).[4]

2. Respondent is an Illinois limited partnership that owns 15 floors of office space in a building in Chicago's central business district. Pet. App. 2a. Petitioner holds a non-recourse mortgage on the office property as security for a $93 million loan. *Ibid.* Respondent defaulted in January 1995. Shortly thereafter, petitioner's predecessor began foreclosure proceedings in state court. *Ibid.* Respondent promptly filed a voluntary petition for reorganization under Chapter 11, which automatically stayed the foreclosure proceeding. *Ibid.*; 11 U.S.C. 362.

[4] Even if a plan satisfies all of paragraph 2's minimum requirements, the court still must independently determine that the plan is "fair and equitable." 11 U.S.C. 1129(b)(1) and (2).

Petitioner is the major creditor in the bankruptcy proceeding. The only other outside creditors were a state claim for real estate taxes and $90,000 in trade debt. Pet. App. 3a, 103a. Respondent's available assets were the property and a cash account of approximately $3 million. *Id.* at 103a. The bankruptcy court valued the office space at $54.5 million. The court thus allowed petitioner a secured claim in the amount of $54.5 million and an unsecured claim of $38.5 million, which reflected the deficiency between the actual property value and the remaining debt owed by respondent. See 11 U.S.C. 506(a), 1111(b).

It is undisputed that respondent's primary motivation for seeking reorganization was to retain ownership of the property so that its partners could avoid approximately $20 million in personal tax liabilities that would come due upon a sale of the real estate. Pet. App. 3a, 59a. Accordingly, respondent proposed a plan under which its partners would contribute $6.125 million over the course of five years and, in exchange, would retain an ownership interest in the reorganized debtor. The trade creditors and state tax claim would be paid in full. Petitioner's secured claim would be paid, but under new terms: prompt cash payment of $1,149,500 plus a secured, 7-year note (extendable to 10 years at the debtor's option). In addition, petitioner would receive a "commitment fee"[5] and a 50% "participation interest" in the value of the property at the end of the note period. *Id.* at 4a-5a, 57a-59a.[6]

[5] The plan proposed a fee between $266,975 and $545,000; the court set the fee at $266,975. Pet. App. 127a n.4.

[6] From the remaining value of the property at the time of sale or refinance, payments would occur in the following order: "(a) on petitioner's unsecured deficiency claim, payment in full, without interest; (b) for the new capital contributions, payment in full, with interest at varying rates; (c) on the second mortgage held by the general partner,

Petitioner opposed the plan, but the class of trade creditors voted to accept it.[7] The bankruptcy court approved the plan over petitioner's objection that it violated the absolute priority rule. Pet. App. 135a-140a. The district court affirmed. *Id.* at 79a-82a.

3. A divided panel of the Seventh Circuit affirmed. Pet. App. 1a-47a. The majority ruled that this Court's decision in *Case* v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), established a new value exception to the absolute priority rule. Pet. App. 14a. The majority acknowledged that, "[a]s a matter of abstract logic, and certainly of semantics," respondent's partners were "receiving or retaining" property under the plan "on account of" their "old equity interest" in the debtor, within the meaning of the absolute priority rule. *Id.* at 17a. The court determined, however, that Congress "might well have intended" to require "a more direct causation." *Ibid.* Under this reading, the partners were "allowed to participate in the reorganized entity 'on account of' a new, substantial, necessary and fair infusion of capital," rather than on account of their interest in the debtor. *Ibid.*

Judge Kanne dissented. Pet. App. 32a-46a. He concluded that the new value exception crafted by the majority "belittles the straightforward language of § 1129(b)(2)(B)(ii)" and overlooks that the debtor's partners were permitted to infuse new value into the debtor solely "'on account of'

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full payment with 10% simple interest; and (d) to the debtor's partners in proportion to their contribution of new capital." Pet. App. 58a.

[7] Because the plan classed petitioner's unsecured claim separately from the trade creditors' unsecured claims, petitioner's opposition did not suffice to halt the plan. See 11 U.S.C. 1126(c), 1129(a)(10). The bankruptcy court rejected petitioner's contention that the classifications were gerrymandered to obtain the requisite approval by a single class. Pet. App. 147a-152a. Petitioner did not seek this Court's review of that issue. Petitioner raised a number of other objections to the plan (*id.* at 114a-135a, 141a-154a), but it did not seek this Court's review of those questions either.

their unique status as prior equity holders." *Id.* at 34a. Judge Kanne further noted that, in the immediately preceding subsection of Section 1129, the phrase "'on account of such claim' takes a simple, ordinary 'but for' or 'because of' meaning," and urged that the identical words in the two subsections should be given the identical meaning. *Id.* at 37a. In addition, the dissent challenged the majority's assumption that Congress implicitly incorporated the new value exception into the 1978 Bankruptcy Code. *Id.* at 41a-42a. Finally, the dissent pointed out that the new value exception "creates an anachronism by cutting and pasting pre-Code practice into a fundamentally different bankruptcy context." *Id.* at 46a.

SUMMARY OF ARGUMENT

As evidenced by the plain language, structure, and legislative history of the Bankruptcy Code, Congress intended the absolute priority rule to be absolute. Respondent's attempt to engraft a new value exception onto Section 1129(b) rests upon an unnatural and artificial construction of the statutory text and relies upon 40-year-old dicta and policy arguments that have little modern currency due to Congress's fundamental restructuring of bankruptcy law in 1978. If Congress had wanted to craft an exception for new value or to permit debtors to retain property interests in advance of creditors, it would have said so explicitly, as it has in other chapters of the Bankruptcy Code.

1. The absolute priority rule prohibits confirmation of any plan under which the owners of a failed business retain or receive property "on account of" their interest in the debtor while objecting senior creditors go unpaid. As it does throughout Chapter 11, "on account of" means "for" or "because of." The phrase thus refers to the basis on which the holder of a claim or interest has some entitlement to the debtor's property.

The office space retained by and the equity interests acquired by the debtor's owners in this case were "on

account of" their prior equity claims. The owners' claim or interest in the debtor was the defining criterion for acquiring property under the plan. Money alone was insufficient. The court of appeals, in effect, read the absolute priority rule to prohibit junior interests from acquiring property ahead of senior unpaid claimants only when that property is obtained "*entirely* on account of" or "*solely* on account of" a prior, junior interest, and not where new money is also contributed. Such words of limitation, however, make no appearance in the statutory text, and judicial imposition of such a construction would be inconsistent with the phrase's meaning elsewhere in Chapter 11.

2. Resort to legislative history is unnecessary because the statutory text forecloses the new value exception. In any event, the history of the Bankruptcy Reform Act of 1978 confirms the inappropriateness of reading such an exception into the absolute priority rule. The exception makes no appearance in the House or Senate Report, and the categorical terms in which the House Report speaks counsel against such a substantial deviation from the statute's text. Congress, moreover, considered and rejected proposed bills that explicitly contained a new value exception. Congress chose, instead, to allow voting by classes of claimants and the economic interests of creditors to determine whether a debtor's plan to infuse capital is workable and in the creditors' best interests. Allowing the debtor and the bankruptcy court to impose a new value plan over the objection of a major creditor, as occurred here, would frustrate Congress's carefully calibrated scheme and fundamentally skew the balance between debtors and creditors struck by Chapter 11.

3. Modification of the statutory text cannot be justified on the ground that Congress implicitly incorporated the new value exception into the Bankruptcy Code. At the time the Code was enacted, the new value exception lived only in infrequent dicta. Neither this Court nor any other

decisions of which we are aware had upheld imposition of a new value plan over the objection of a dissenting creditor. A rule of statutory construction that places on Congress the burden of expressly disavowing every bankruptcy option mentioned in dicta would be both inappropriate and unworkable.

The bankruptcy world in which the new value dicta were uttered, moreover, bears little resemblance to that governed by the 1978 Bankruptcy Code. Under prior law, a single, minority creditor could derail a reorganization plan over the consent of all creditor classes. The provision for class-based consent to plans in the 1978 Bankruptcy Code eliminates that problem. Thus, new value plans under the modern Bankruptcy Code would serve, not to circumvent the gadfly creditor, but to impose a plan over the objection of the debtor's largest creditor. There is no adequate basis to believe that Congress's plainly worded absolute priority rule was intended to permit—as occurred here—schemes that leave property in the hands of the very owners who presided over the business's insolvency solely to perpetuate their tax shelter, while the property's major creditor goes unpaid.

ARGUMENT

SECTION 1129(b) OF THE BANKRUPTCY CODE BARS CONFIRMATION OF A REORGANIZATION PLAN THAT PERMITS THE DEBTOR'S EQUITY OWNERS TO RETAIN OR ACQUIRE PROPERTY OVER THE OBJECTION OF A SENIOR, UNPAID CREDITOR CLASS

The "absolute priority rule" provides that the "holder of any claim or interest that is junior to the claims of" an unsecured and unpaid creditor class "will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. 1129(b)(2)(B)(ii). Here, the equity interests of respondent's owners are unquestionably junior to petitioner's unsecured deficiency claim.

Nor is there any doubt that the plan permitted the junior equity interests both to retain and receive "property." The owners retained possession of the office space and received the exclusive option to purchase ownership interests in the reorganized debtor.[8] The only question is whether that property was received and retained "on account of" the owners' equity interest in the debtor. The language, structure, and legislative history of Chapter 11 leave no doubt that it was.[9]

A. The Plain Language Of The Absolute Priority Rule Admits Of No New Value Exception

1. The task of determining whether an unwritten new value exception exists "begins where all such inquiries must begin: with the language of the statute itself." *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). Nothing in the text of Chapter 11 recognizes or supports the existence of a new value exception. To the contrary, the absolute priority rule is (true to its name)

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[8] See *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 207-208 (1988); see also *Phillips* v. *Washington Legal Found.*, No. 96-1578 (June 15, 1998), slip op. 12; *In re Coltex Loop Central Three Partners*, 138 F.3d 39, 43 (2d Cir. 1998); *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir.), cert. denied, 506 U.S. 866 (1992); *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990); D. Baird, *The Elements of Bankruptcy* 261 (1993) ("The right to get an equity interest for its fair market value is 'property' as the word is ordinarily used. Options to acquire an interest in a firm, even at its market value, trade for a positive price. They are bought and sold every day.").

[9] The courts of appeals have split on this question. Compare *Coltex*, 138 F.3d at 42-45 (no new value exception); *In re Greystone III Joint Venture*, 995 F.2d 1274, 1282-1284 (same), vacated in part, 995 F.2d 1284 (5th Cir. 1991), cert. denied, 506 U.S. 821 (1992), with Pet. App. 1a-31a (new value exception exists); *In re Bonner Mall Partnership*, 2 F.3d 899, 906-917 (9th Cir. 1993) (same), cert. dismissed, 513 U.S. 18 (1994); see also *Bryson*, 961 F.2d at 503-505 (new value exception is questionable) (dicta); *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986) (assuming that new value exception exists).

absolute in its terms. The new value exception relied upon by the court of appeals thus "has no statutory reference point." *Shannon* v. *United States*, 512 U.S. 573, 583 (1994).

By contrast, when Congress wishes to carve out exceptions to its general rules based on the payment of "new value," it does so explicitly. See 11 U.S.C. 547(a)(2) and (c) (exception to power of trustee to avoid certain pre-petition transfers). Similarly, where Congress intends to permit debtors to retain some property before creditors are paid in full — as in Chapters 12 and 13 of the Bankruptcy Code — it omits the absolute priority rule from the criteria for confirmation of a plan. 11 U.S.C. 1225, 1325; see also *In re A.V.B.I., Inc.*, 143 B.R. 738, 747 (Bankr. C.D. Cal. 1992). "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act," courts must "presume[] that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Gozlon-Peretz* v. *United States*, 498 U.S. 395, 404 (1991).

2. The statutory language, moreover, is unambiguous in prohibiting new value plans. According to the absolute priority rule, until senior creditors are paid in full, junior claimants may not obtain any property "on account of" their junior interest in the debtor. The common understanding of the phrase "on account of," both now and at the time the Bankruptcy Code was enacted, is "for," "because of," and "by reason of."[10] Throughout Chapter 11, and Section 1129 in particular, the phrase "on account of" appears in a context that confirms that ordinary meaning because it describes the basis on which a claimant may receive

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[10] See, *e.g.*, *The Random House Dict. of the English Language* 13 (2d ed. 1987); *Webster's Third New Int'l Dictionary* 13 (1976); *The American Heritage Dictionary* 9 (1980); cf. *Cohen* v. *De La Cruz*, 118 S. Ct. 1212, 1217 (1998) (under Bankruptcy Code, debt "for" means debt "on account of").

property of the debtor.[11] In other words, in bankruptcy proceedings, creditors receive property distributions "for," "because of," and "on account of" their respective claims and interests in the debtor.[12]

Even outside the bankruptcy context, "on account of" is generally accorded a similar connotation. See, *e.g.*, *Turner Broadcasting System, Inc.* v. *FCC*, 512 U.S. 622, 641 (1994) (discussing government action "that stifles speech on account of its message"); *Spallone* v. *United States*, 493 U.S. 265, 268 (1990) (discussing housing discrimination "on account of race or national origin").

The plan explicitly provided for the debtor's owners to retain and receive property "because of" and "by reason of" their equity interests in the debtor. The plan gave the partners the exclusive right to contribute new capital and receive, in exchange, ownership shares in the reorganized debtor. J.A. 37-39. No other creditor, participant in the bankruptcy proceeding, or outsider was eligible to receive that property. The owners' "junior claim or interest" in the debtor, 11 U.S.C. 1129(b)(2)(B)(ii), thus defined their eligibility both to retain possession of the office space and to obtain shares in the reorganized debtor. It would therefore blink reality to say that the owners did not obtain property "because of" or "on account of" their equity holdings in the debtor.[13]

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[11] See, *e.g.*, 11 U.S.C. 1111(b)(1)(A); 11 U.S.C. 1129(a)(7)(A)(ii) and (B), (a)(9)(A) and (C); 11 U.S.C. 1129(b)(2)(A)(i)(II), (2)(B)(i), (2)(C)(i) and (ii).

[12] Other provisions of the Bankruptcy Code employ the phrase in a similar manner. See, *e.g.*, 11 U.S.C. 547(b)(2), 547(c)(4)(B). *Webster's* also adds "for the sake of" to its definition of "on account of." *Webster's Third*, *supra*, at 13. That definition is unhelpful to respondent and is an unnatural connotation for the phrase as it appears in other sections of the Code.

[13] It is sometimes suggested that such exclusivity simply reflects the fact that no one other than the debtor's owners would want to acquire interests in an insolvent business. *E.g.*, *Bonner Mall*, 2 F.3d at 911. Even if accurate, that observation would not change the plain language of the statute or its signification. Furthermore, major creditors may well be interested in acquiring shares in the reorganized debtor so that they can obtain a controlling interest in the business and thus dictate its future operation or dissolution. See *Greystone*, 995 F.2d at 1283.

3. While both courts of appeals that have recognized a new value exception invoked the alleged ambiguity of Congress's language to justify resort to non-textual interpretation, neither court, in fact, had difficulty understanding the absolute priority rule's ordinary meaning. The Seventh Circuit candidly acknowledged that "[a]s a matter of abstract logic, and certainly of semantics," the owners' acquisition and retention of property was "on account of" their equity interests in the debtor. Pet. App. 17a. Likewise, the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899 (1993), cert. dismissed, 513 U.S. 18 (1994), "recognize[d] that in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners." *Id.* at 909. Both courts nevertheless concluded that Congress intended a "more direct causation," and thus ruled that the property interests were obtained "on account of" the infusion of new capital. Pet. App. 17a; see also *Bonner Mall*, 2 F.3d at 909. There are three flaws in that reasoning.

First, that construction rests on an artificial singleness of causality. The court of appeals effectively inserted "solely" or "entirely" in front of the phrase "on account of," insisting that the junior claim or interest be the exclusive cause for the property acquisition. "Had Congress intended the narrow construction" that the court of appeals adopted, "it could have so indicated. It did not, and [this Court should] decline to introduce that additional requirement on [its] own." *Smith* v. *United States*, 508 U.S. 223, 229 (1993); see also *Kawaauhau* v. *Geiger*, 118 S. Ct. 974, 977 (1998) (declining to adopt interpretation of

Bankruptcy Code where, if Congress so intended, "Congress might have selected an additional word or words").

Such a straitened reading, moreover, does not comport with ordinary usage. Indeed, under most plans, a claimant is not paid solely or entirely because of its claim, but also because the debtor believes that the manner in which payment is allotted will increase the prospects for business revitalization or for plan confirmation. That the phrase "on account of" is sufficiently capacious to embrace more than one causative factor at a time does not justify altering or limiting its core meaning.[14]

In addition, "on account of" does not appear in contradistinction to any words or phrases that warrant according it such a narrow reading. See *Smith*, 508 U.S. at 229; *Smiley* v. *Citibank (South Dakota), N.A.*, 517 U.S. 735, 746-747 (1996). Nor, given the proliferation of the phrase "on account of" throughout Section 1129, would there have been any reason for Congress to impose such a cramped construction in those other contexts. See *Cohen*, 118 S. Ct. at 1217 ("equivalent words have equivalent meaning when repeated in the same statute").

Second, the court of appeals' reasoning overlooks that the plan afforded the equity holders an option to purchase shares before they contributed any capital at all. The acquisition of that property interest — the option to purchase new shares — was entirely and exclusively attributable to the partner's junior equity interest in the debtor. The plan did not offer any creditor, or anyone else for that matter, an equivalent opportunity to purchase interests in the reorganized debtor.

Third, the court of appeals' ruling fails its own direct causation test. The contribution of new money alone could

[14] Cf. *Smith*, 508 U.S. at 228-237 ("use" of a firearm includes both use as a firearm and for barter); *Phillips* v. *Martin Marietta Corp.*, 400 U.S. 542, 544 (1971) (employment discrimination against women with pre-school-age children constitutes discrimination on account of sex) (per curiam).

not entitle a person to equity interests under the plan. Otherwise, petitioner or another creditor could have purchased a controlling interest in respondent. While the willingness to pay money was a necessary condition of the purchase, it was not sufficient. Status as the holder of an existing equity interest was the indispensable prerequisite to participation in the sale.[15]

4. Holding that the owners acquired property "on account of" or because of their equity interests would not, as some have suggested, render the phrase surplusage. See *Bonner Mall*, 2 F.3d at 909. The "on account of" language identifies for which claim persons are receiving property under a plan. The phrase, in other words, makes clear that the absolute priority rule is claim specific, rather than creditor specific. Bankruptcy creditors can, and often do, have more than one type of claim. "On account of" ensures that, while those creditors cannot receive property because of their equity interests ahead of an unsecured creditor, payments on account of their separate secured and non-junior unsecured claims will not run afoul of the absolute priority rule.

5. Just as the task of construing Section 1129 begins with its plain text, "[i]n this case it is also where the inquiry should end, for where, as here, the statute's language is plain, the sole function of the courts is to enforce it according to its terms." *Ron Pair*, 489 U.S. at 241 (internal quotation marks omitted). Given the precision with which Congress has spoken, "reference to legislative history and to pre-Code practice is hardly necessary." *Ibid.* Policy arguments and (alleged) historical practice alone cannot justify the creation of "an extra-statutory doctrine," *Bonner Mall*, 2 F.3d at 910 n.25. In any event,

[15] The court of appeals erred in finding the statutory text ambiguous merely because some courts and law professors disagree about its construction. See, *e.g.*, *Smith*, 508 U.S. at 227-237 (ordinary meaning of "use" discerned entirely from statutory text, despite inter-circuit conflict and dissent of three Justices).

neither the legislative history nor pre-Code practice supports the court of appeals' decision.

B. The Legislative History Recognizes No New Value Exception To The Absolute Priority Rule

"Given the clarity of the statutory text, respondent's burden of persuading [the Court] that Congress intended to create or to preserve a special rule" for new value plans "is exceptionally heavy." *Union Bank* v. *Wolas*, 502 U.S. 151, 155-156 (1991). The legislative history of the Bankruptcy Reform Act provides respondent no assistance in that task.

1. The predecessor to the 1978 Bankruptcy Code contained four separate reorganization chapters: Chapter VIII, 11 U.S.C. 205 (1970), governed railroad reorganizations; Chapter X, 11 U.S.C. 501-676 (1970), covered corporate reorganizations; Chapter XI, 11 U.S.C. 701-799 (1970), regulated arrangements and compositions for corporations, partnerships, and individuals; and Chapter XII, 11 U.S.C. 801-926 (1970), established reorganization procedures for non-corporate entities engaged in real estate. H.R. Rep. No. 595, 95th Cong., 1st Sess. 221 (1977). Of the four, only Chapters VIII and X predicated confirmation of a reorganization plan on a finding by the court that the plan was "fair and equitable." See 11 U.S.C. 205(e), 621 (1970). Those sections, however, offered no definition of "fair and equitable." It was in the course of defining the "fair and equitable" standard that courts adopted the absolute priority rule to limit insider collusion. *Ahlers*, 485 U.S. at 202.[16]

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[16] See also *Northern Pacific Ry.* v. *Boyd*, 228 U.S. 482, 504-508 (1913) (absolute priority rule prevents senior creditors and stockholders from colluding to impair the interests of intermediate creditors); *Louisville Trust Co.* v. *Louisville N.A. & C. Ry.*, 174 U.S. 674, 684 (1899); *Railroad Co.* v. *Howard*, 74 U.S. (7 Wall.) 392, 409-411 (1869); J. Ayer, *Rethinking Absolute Priority after Ahlers*, 87 Mich. L. Rev. 963, 1022 (1989).

By the time of *Case* v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), the absolute priority rule had become a "fixed principle" for the determination of whether reorganization plans satisfied the "fair and equitable" standard. *Id.* at 116. In *Los Angeles Lumber*, this Court refused to confirm a reorganization plan under Section 77(b) of the Bankruptcy Act of 1898, ch. 204, 47 Stat. 1475, 11 U.S.C. 205(e) (1934) (Chapter X's predecessor), because it violated the absolute priority rule. 308 U.S. at 122-132. The Court ruled that the stockholders' pledge of their "financial standing and influence in the community" and the "continuity of management" constituted too "ephemeral" a contribution to justify retention of ownership interests in the reorganized enterprise at the expense of unpaid senior creditors. *Id.* at 122-125. The Court stated in dicta, however, that "there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor." *Id.* at 121. Where the old stockholders' participation is a "necessity" and they "make a fresh contribution and receive in return a participation reasonably equivalent to their contribution," the Court explained, "the creditor cannot complain that he is not accorded his full right of priority against the corporate assets." *Id.* at 121-122 (internal quotation marks omitted). Nothing in the legislative history suggests that Congress intended to incorporate those new value dicta into the absolute priority rule it codified in Section 1129.

2. Neither the House nor the Senate Report mentions, let alone supports, the existence of the new value exception discussed in *Los Angeles Lumber*. See H.R. Rep. No. 595, *supra*; S. Rep. No. 989, 95th Cong., 2d Sess. (1978). The House Report does note the *Los Angeles Lumber* decision. H.R. Rep. No. 595, *supra*, at 222 n.8. The citation only indicated, however, that the absolute priority rule applied to Chapter X reorganizations. That statement could hardly be characterized as an endorsement of the new value dicta.

Indeed, the House Report's discussion of the absolute priority rule is emphatic and unconditional in its breadth. "Simply put, the bill requires that the plan pay any dissenting class in full before any class junior to the dissenter may be paid *at all*." H.R. Rep. No. 595, *supra*, at 224 (emphasis added). Under the absolute priority rule, the Report reiterated, if an impaired class is paid less than in full, "then *no* class junior [to it] may receive *anything* under the plan." *Id.* at 413 (emphasis added).[17] Furthermore, the House Report acknowledged that its codification of the absolute priority rule did not entail a wholesale importation of the judicially created rule. *Id.* at 224 ("The rule is a partial application of the absolute priority rule now applied under chapter X."); *id.* at 414. Because Congress explicitly modified the scope of the judicial rule it incorporated, this Court should be especially reluctant to superimpose additional judicial glosses on the statutory text.

3. a. The evolution of the bankruptcy reform legislation also evidences Congress's intention not to codify a new value exception to the absolute priority rule. In this regard, "it is crucial here to grasp not only what Congress did, but what it chose not to do." J. Ayer, *Rethinking Absolute Priority after Ahlers*, 87 Mich. L. Rev. 963, 978 (1989).

The revision process began in 1970 with the creation of the Commission on the Bankruptcy Laws of the United

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[17] See also H.R. Rep. No. 595, *supra*, at 416 (cramdown plan can be confirmed if "junior classes *will receive nothing* under the plan") (emphasis added), 417 (the Bill "allows confirmation if junior interests are not compensated"), 225 (discussing absolute priority rule without hinting at new value exception). The Senate Report offered little discussion of the absolute priority rule and contained no mention of the new value exception. S. Rep. No. 989, *supra*, at 126-128. Because the version of Chapter 11 that was ultimately enacted derived predominantly from the House bill, the statements in the House Report are more relevant to the statutory inquiry presented in this case.

States "to study and recommend changes in the bankruptcy laws." H.R. Rep. No. 595, *supra*, at 2 (footnote omitted). The Commission filed a report with Congress in 1973 in which it proposed the explicit adoption of a new value exception. H.R. Doc. No. 137, 93d Cong., 1st Sess. (1973), *reprinted at* Vol. B *Collier on Bankruptcy* App. Pt. 4-518 to 4-519, 4-815 (15th ed. rev. 1998). The Commission also suggested expanding the new value exception to allow non-monetary contributions that are "important to the operation of the reorganized debtor." *Id.* at App. Pt. 4-815.

The recommended new value language was included in four proposed bills submitted to the 93d Congress.[18] While the proposed bills contained provisions requiring as a condition of confirmation that a plan be "fair and equitable," none of the proposed bills contained language explicitly codifying the absolute priority rule. The "fair and equitable" standard, moreover, was expressly limited by the proposed new value provision.[19] No further action was taken on the bills. However, each of those bills, with the new value language and the concomitant limitation on the "fair and equitable" standard retained, was reintroduced in the next session of Congress.[20] Extensive hearings were held, during which critics targeted various facets of the proposed new value rule.[21]

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[18] H.R. 10792, 93d Cong., 1st Sess. § 7-303 (1973); H.R. 16643, 93d Cong., 2d Sess. § 7-301(4) (1974); S. 4046, 93d Cong., 2d Sess. § 7-301(4) (1974); S. 2565, 93d Cong., 1st Sess. § 7-303(4) (1973).

[19] H.R. 10792, *supra*, § 7-310(d)(2)(B); H.R. 16643, *supra*, § 7-308(d)(2)(B); S. 4046, *supra*, § 7-308(d)(2)(B); S. 2565, *supra*, § 7-310(d)(2)(B).

[20] H.R. 31, 94th Cong., 1st Sess. §§ 7-303(4), 7-310(d)(2)(B) (1975); H.R. 32, 94th Cong., 1st Sess. §§ 7-301(4), 7-308(d)(2)(B) (1975); S. 235, 94th Cong., 1st Sess. §§ 7-301(4), 7-308(d)(2)(B) (1975); S. 236, 94th Cong., 1st Sess. §§ 7-303(4), 7-310(d)(2)(B) (1975).

[21] See *H.R. 31 and H.R. 32: Bankruptcy Act Revision: Hearings Before the House Subcomm. cn Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., 2d Sess. Pt. 4, at 2160, 2180-2182,

b. In light of the hearings, substantially revised bills emerged from both the House and Senate. The House bill eliminated the language authorizing new value plans and reiterated the "fair and equitable" condition for plan confirmation. The bill did not, however, propose to codify the absolute priority rule. See H.R. 6, 95th Cong., 1st Sess. §§ 1123, 1129(b) (1977). After Congress received further comments from judges, practitioners, and academics, a lengthy mark-up session produced H.R. 8200, 95th Cong., 1st Sess. (1977), the bill that would eventually become law. See H.R. Rep. No. 595, *supra*, at 3; see also H.R. 7330, 95th Cong., 1st Sess. (1977). In the Senate, a bill analogous to H.R. 8200, S. 2266, 95th Cong., 1st Sess. (1977), was introduced. See S. Rep. No. 989, *supra*, at 2.

As in H.R. 6, the new value language was absent from both the House and Senate bills. H.R. 8200, *supra*, §§ 1123, 1129; S. 2266, *supra*, §§ 1123, 1130; see also H.R. 7330, *supra*, §§ 1123, 1129. Unlike the predecessor bills, however, the House and Senate bills now also included a strict codification of the absolute priority rule. See H.R. 8200, *supra*, § 1129(b)(2)(B)(iv) ("the holders of claims or interests of any class of claims or interests, as the case may be, that is junior to such class will not receive or retain under the plan on account of such junior claims or interests any property"); S. 2266, *supra*, § 1130(c)(2)(B)(iv) (same); H.R. 7330, *supra*, § 1129(b)(2)(B)(iv). With slight modifications, H.R. 8200's elimination of new value language and explicit codification of the absolute priority rule became law on November 6, 1978.[22]

2470, 2636 (1976); *S. 235 and S. 236: The Bankruptcy Reform Act: Hearings Before the Senate Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary*, 94th Cong., 1st Sess. Pt. 2, at 382, 557, 624, 710, 716-717, 733, 1044 (1975).

[22] Floor statements by the managers of the legislation confirmed the categorical operation of the absolute priority rule. See 124 Cong. Rec. 32,408 (1978) (statement of Rep. Edwards) (cramdown plan can be confirmed "as long as no class junior to the dissenting class receives

c. The foregoing history of the legislation refutes any contention that Congress meant to retain the very new value language it eliminated and meant to weaken the strictly worded absolute priority rule it enacted. "Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded." *INS* v. *Cardoza-Fonseca*, 480 U.S. 421, 442-443 (1987); see also *Gulf Oil Corp.* v. *Copp Paving Co.*, 419 U.S. 186, 200 (1974) (Court will not assume "that Congress intended a result that it expressly declined to enact").

Significantly, earlier drafts containing the new value language also felt it necessary to qualify the "fair and equitable" standard for plan confirmation by making it expressly subject to the proposed new value exception. This suggests an understanding that, unless specifically qualified, ordinary operation of the fair and equitable standard—and its component absolute priority rule—would preclude the confirmation of a new value plan. Thus, the fact that the legislation Congress enacted not only deleted the new value provision, but also restored the fair and equitable standard free of such restrictions *and* separately codified the absolute priority rule in broadly worded terms forecloses any argument that Chapter 11 implicitly carried forward the new value exception.

For similar reasons, the suggestion (*e.g.*, Pet. App. 20a; *Bonner Mall*, 2 F.3d at 913) that Congress's rejection of the new value proposal signified only opposition to the bills' broad definition of value misses the mark. Had Congress desired a narrower version of the new value exception, it presumably would have revised the proposed new value language rather than erased it entirely and codified instead an unconditional absolute priority rule. In construing the Bankruptcy Code, this Court should be

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anything at all"); 124 Cong. Rec. 34,007 (1978) (statement of Sen. DeConcini) (same).

"directed by [the statute's] words, and not by the discarded draft[s]." *John Hancock Mutual Life Ins. Co.* v. *Harris Trust & Sav. Bank*, 510 U.S. 86, 101 (1993).

4. Congress's rejection of analogous "give-up" plans further undercuts any argument that new value plans are permissible. Under a give-up plan, senior claim holders consent to have some of the property that is owed to them allocated instead to junior classes, even though intermediate classes are not paid in full. See, *e.g.*, *Kansas City Terminal Ry.* v. *Central Union Trust Co.*, 271 U.S. 445 (1926) (bondholders' surrender of value in favor of stockholders). As reported out of committee, the Senate bill would have permitted "a senior creditor to adjust his participation for the benefit of stockholders." S. Rep. No. 989, *supra*, at 127. The Report explained that "junior creditors, who have not been satisfied in full, may not object if, absent the 'give-up', they are receiving all that a fair and equitable plan would give them." *Ibid.* The House Report, by contrast, stated that the absolute priority rule contained in H.R. 8200, *supra*, § 1129(b)(2)(B)(iv) would foreclose give-up plans. H.R. Rep. No. 595, *supra*, at 416 (the absolute priority rule "is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is unimpaired"). The House's language choice prevailed, and the floor statements that were made in lieu of a conference report confirm that the absolute priority rule bars give-up plans.[23]

Of course, if "on account of" bore the narrow meaning ascribed by the court of appeals, then give-up plans would

[23] See 124 Cong. Rec. 32,408 (1978) (statement of Rep. Edwards) ("[T]he House report remains an accurate description of confirmation of section 1129(b). Contrary to the example contained in the Senate report, a senior class will not be able to give up value to a junior class over the dissent of an intervening class unless the intervening class receives the full amount, as opposed to value, of its claims or interests.").

be permissible, because the value the junior interests receive would arguably be "on account of" an independent decision of the senior creditors. The "on account of" language, however, should not be construed to admit through the back door schemes circumventing the absolute priority rule—whether new value or give-up plans—that Congress specifically considered and rejected during the legislative process.[24]

C. Rejection Of A New Value Exception Is Consistent With Pre-Code Practice

This Court is "reluctant to accept arguments that would interpret the [Bankruptcy] Code * * * to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992). The court of appeals concluded that the new value exception was "ensconced" in pre-Code bankruptcy practice and thus that Congress "'must have enacted the Code with a full understanding' of the absolute priority rule and its new value corollary." Pet. App. 20a (quoting *Dewsnup*, 502 U.S. at 419). There are several significant flaws in that reasoning.

1. Resort to pre-Code practice is appropriate only when the statutory language is ambiguous. *Ron Pair*, 489 U.S. at 241; cf. *Dewsnup*, 502 U.S. at 417 (noting ambiguity in text at issue), 419-420. Congress spoke with such straightforward language in enacting the absolute priority rule that resort to extra-statutory tools of interpretation is both unnecessary and inappropriate.

[24] *Los Angeles Lumber* relied heavily on *Kansas City Terminal*, *supra*, to undergird its new value dicta. 308 U.S. at 121-122. *Kansas City Terminal*, however, involved a give-up plan, not a new value plan. 271 U.S. at 453-456. The fact that the absolute priority rule prohibits give-up plans further counsels against a construction of the rule that would implicitly authorize new value plans while barring the give-up plans that provided the foundation for the new value dicta.

2. The ability of a court to perceive references to a bankruptcy procedure in a few cases prior to 1978 is an insufficient basis for engrafting an unwritten exception onto the Bankruptcy Code. The pre-Code practice must have been "clearly established." *Dewsnup*, 502 U.S. at 418; see also *Kelly* v. *Robinson*, 479 U.S. 36, 45 n.6, 46 (1986) (rule that criminal restitution obligations are non-dischargeable was "widely accepted" and "established" by 1978; only one court had ruled otherwise). The new value exception was not. To the contrary, it lived only in occasional dicta: this Court has never confirmed a new value plan, and neither (to our knowledge) did any other court before 1978.

a. In *Los Angeles Lumber*, the Court first intimated in dicta that a new value exception might be available. 308 U.S. at 121-122.[25] The *Los Angeles Lumber* dicta appeared again in *Marine Harbor Properties* v. *Manufacturer's Trust Co.*, 317 U.S. 78 (1942), but the issue decided was whether the petition was properly dismissed because it was not filed in good faith. *Id.* at 81. The new value dicta arose only in a hypothetical discussion of potential reorganization options. *Id.* at 85-86; see also *Consolidated Rock Prods. Co.* v. *Du Bois*, 312 U.S. 510, 529 n.27 (1941). The dicta made their final pre-Code appearance in *Mason* v. *Paradise Irrigation Dist.*, 326 U.S. 536, 541-543 (1946),

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[25] A brief filed by the United States as amicus curiae in *Los Angeles Lumber* recognized the potential application of a narrow new value exception to the judicially created absolute priority rule. See U.S. Amic. Br. at 14, 40-42, *Case* v. *Los Angeles Lumber Prods. Co.*, *supra*, (Nos. 23 & 24). Our subsequent research has shown that suggestion not to be a correct reflection of the law at that time. In any event, whatever the state of the law in 1939, we have consistently taken the position in subsequent filings in this Court, as we do here, that no new value exception was clearly established at the time of the Bankruptcy Reform Act of 1978, and that Chapter 11 of the 1978 Code does not contain a new value exception. See U.S. Amic. Br., *Ahlers*, *supra*, and *Bonner Mall Partnership*, *supra*.

more than 30 years before enactment of the Code. That case involved the provision of new value by a creditor (not an equity holder) and concerned only whether the differential treatment of creditors within a class precluded confirmation of the plan. *Id.* at 538-542.

Accordingly, the fact that this Court never has addressed the new value issue except in dicta "or relied upon this limitation * * * counsels against concluding that the limitation was well recognized." *Ron Pair*, 489 U.S. at 247.

b. The new value dicta also had no independent existence in the decisions of lower courts. In fact, we are aware of no reported case under the old Chapter X (or its predecessor Section 77(b)) adopting the new value dicta as the basis for confirmation of a plan in the years before 1978.[26] In any event, even if the lower courts had occasionally relied on this Court's dicta, that would not render the practice "well recognized" for purposes of incorporation into the Code. *Ron Pair*, 489 U.S. at 247; see also *United Savings Ass'n* v. *Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 381 (1988).

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[26] See Pet. App. 42a n.5 ("Under Chapter X, no shareholder ever convinced a court that it contributed sufficient value to retain an interest under the new value concept, and no reported case expressly adopted *Case*'s new value *dicta* as its holding until the Code's enactment in 1978."); *Coltex*, 138 F.3d at 44; *Greystone*, 995 F.2d at 1282 ("There is no *there* there."); 7 *Collier*, *supra*, ¶ 1129.04[4][c], at 1129-106 to 1129-108 & n.164 (15th ed. rev. 1998); B. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991); Ayer, *supra*, 87 Mich. L. Rev. at 1016 (new value "is nowhere present as a rule of decision in Chapter X cases. New value under Chapter X, then, is an illusion."). Because Chapter XI, under which most other reorganizations were filed prior to 1978, did not contain the absolute priority rule, no cases under that provision addressed the new value dicta either. *Coltex*, 138 F.3d at 44; 7 *Collier*, *supra*, ¶ 1129.04[4][c], at 1129-106 to 1129-107.

c. In sum, rather than "ensconced in our bankruptcy practice" (Pet. App. 20a), the new value exception was "seemingly moribund" by 1978. 7 *Collier*, *supra*, ¶ 1129.04[4][c], at 1129-108. The new value exception's brief flicker in bankruptcy practice is an insufficient basis for importing it into the Code, especially in the face of Congress's plain language and the adverse legislative history. See *Ron Pair*, 489 U.S. at 246 (practice of denying post-petition interest was "recognized by only a few courts and often dependent on particular circumstances"); see also *Timbers*, 484 U.S. at 381.

3. Creation of a new value exception would be inappropriate, as well, because the confirmation scheme crafted by Congress in Section 1129 already occupies the territory covered by the new value dicta. *Wolas*, 502 U.S. at 159. The comments in *Los Angeles Lumber* addressed a concern under the prior Chapter X that a single, minority creditor could employ the absolute priority rule to block new value plans that promote the economic interests of the vast majority of creditors in a reorganization proceeding. In *Los Angeles Lumber*, for example, although more than ninety percent of the creditors and stockholders had approved the reorganization plan, 308 U.S. at 111-112, the objection of a single bondholder who was owed $18,500 was sufficient to bar the plan. See also *Mason*, 326 U.S. at 545-546 & n.14.

In Chapter 11 of the 1978 Bankruptcy Code, Congress created a scheme of structured creditor democracy. Approval of plans and invocation of the absolute priority rule are left to classes of creditors, who act by class vote. A majority of the creditors and two-thirds of the total dollar amount of the claims within a class are required for assent. 11 U.S.C. 1126(c), 1129(a)(8). Also unlike pre-Code practice, if a plan is adopted by consent under 11 U.S.C. 1129(a), the court cannot independently veto it through application of the fair and equitable standard. Only cramdown plans trigger such judicial superintendence. 11

U.S.C. 1129(b)(1). When considered in conjunction with the absolute priority rule, the class democracy principles embodied in Chapter 11 reflect a deliberate choice by Congress of how best to remedy the gadfly creditor problem. By selecting class-based elections, Congress trusted the creditors—who have firsthand experience with the insolvent enterprise and who can best gauge the local business climate—to act in their own economic self interest. When a plan truly maximizes the prospects of recovery and compensation, the requisite majority of creditors can be expected to approve it.[27] Where creditor consent is not obtained, the absolute priority rule prevents the debtor and courts from second-guessing that business judgment. As this Court noted in *Ahlers*, even if a court believes that unsecured creditors "would be better off if respondents' reorganization plan was confirmed * * * [,] that determination is for the creditors to make in the manner specified by the Code * * * and courts applying the Code must effectuate their decision." 485 U.S. at 207.[28]

The new value exception, by contrast, vests "power in the *judge* to 'sell' stock to the managers even when the creditors believe that this transaction will *not* augment the value of the firm." *Kham & Nate's Shoes*, 908 F.2d at 1360. Because Congress already enacted particular provisions to fix the problem that gave rise to the new value dicta, it would be illogical to assume that Congress intended simultaneously to incorporate such a dramatically

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[27] Studies confirm this. See, *e.g.*, L. LoPucki & W. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990); J. Franks & W. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989).

[28] See also H.R. Rep. No. 595, *supra*, at 224 ("The premise of the bill's financial standard for confirmation" is that the parties "should make their own decision on the acceptability of the proposed plan of reorganization"; "The parties are left to their own to negotiate a fair settlement."), 226.

different and unstated solution to the same problem. *Wolas*, 502 U.S. at 158.[29] Rather, "the fact that Congress carefully reexamined and entirely rewrote" the reorganization provision in 1978 "supports the conclusion that the text of [Section 1129] as enacted reflects the deliberate choice of Congress." *Id.* at 160.

This is, moreover, not a case where the legislative history is silent. Cf. *Dewsnup*, 502 U.S. at 419. As noted earlier, Congress considered for a number of years versions of bankruptcy reform legislation that authorized new value plans. But in the final legislation, "Congress moved in the other direction, enacting the [absolute priority] rule in an uncompromising form" and choosing to rely, instead, on class democracy to authorize those new value plans that truly maximize the creditors' and debtors' welfare. *Kham & Nate's Shoes*, 908 F.2d at 1362. The court of appeals' decision "is at war with this legislative history." *Wolas*, 502 U.S. at 160 n.15.

4. Finally, the new value dicta are ill-suited for bankruptcy practice under the modernized 1978 Code. Bankruptcy practice, especially in the reorganization arena, "changed substantially in the * * * 40 years" intervening between *Los Angeles Lumber* and the 1978 Bankruptcy Reform Act. H.R. Rep. No. 595, *supra*, at 233.[30] Because the 1978 Code checked the disproportionate power of minority creditors in other ways, new value plans are now apt to be used by debtors and a single class of minority creditors to frustrate the *majority* creditor and to force it into substantial and ongoing financial relationships with the debtor which it no longer desires.

[29] Even the court of appeals recognized that "[the new value exception's] necessity may not be as great today as it was in an earlier period." Pet. App. 22a.

[30] See also H.R. No. 595, *supra*, at 221 ("In 1938, the business reorganization concept was not nearly as well developed as it is today, and the [old statutory] chapters reflect a certain lack of sophistication in handling the myriad problems of modern corporate finance.").

See J.A. 102 ("[W]e do not want to be in a ten year contractual relationship with the debtor."). The fact that a significant percentage of reorganizations ultimately fail underscores the inequity of adopting a new value exception that forces major creditors to subsidize business operations that, in the creditors' judgment, simply postpone the inevitable.[31]

Furthermore, the prior Chapter X (and its predecessor Section 77(b)), provided for the appointment of trustees to supervise the reorganization process. See *A.V.B.I.*, 143 B.R. at 743. Old owners thus could "buy back into the management of the company" only after a trustee "examined the books and operations and * * * unearthed any dishonesty or mismanagement." *Ibid.* Under Chapter 11's debtor-in-possession provision, however, a new value exception would permit uninterrupted control by the debtor's owners. "Creditors often fear that such cases are run for the private benefit of existing salaried management and the equity holders, with the intent of unfairly squeezing out the creditors." *Ibid.*

Correspondingly, the 1978 Bankruptcy Code sharply limited the power of courts to administer equity in a manner untethered to the statutory language. *Ahlers*, 485 U.S. at 206 ("[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."). Congress took it upon itself to offer an elaborate definition of "fair and equitable," rather than leave the standard to judicial development. In these circumstances, it is particularly unlikely that Congress intended silently to import a new value exception, with the attendant need for courts to

[31] See *In re Kroh Bros. Development Co.*, 100 B.R. 487, 500 (Bankr. W.D. Mo.) ("The Court notes that many, if not most, reorganizations fail."), appeal denied, 101 B.R. 1000 (W.D. Mo. 1989); B. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 Com. L. J. 290, 304 & n.90 (1996); S. Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate?*, 97 Com. L. J. 297 (1992).

define the exception's unwritten terms, such as "money or money's worth," "necessity," and "reasonable equivalence."

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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JUNE 1998

APPENDIX

TITLE 11-BANKRUPTCY

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive—

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition than a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this

subsection, the governmental unit has the burden of proof on the issue of avoidance.

Supreme Court, U.S.
FILED
JUN 26 1998
CLERK

(10)

No. 97-1418

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF OF THE *AMICI CURIAE* AMERICAN BANKERS ASSOCIATION AND CALIFORNIA BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Bankruptcy Code authorizes the confirmation of a Chapter 11 plan of reorganization that provides that existing equity owners will contribute "new value" to the reorganization and will own equity in the reorganized debtor, even though the plan does not provide for full payment to a senior, objecting class of unsecured creditors.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES iii

INTEREST OF THE AMICUS CURIAE 2

SUMMARY OF THE ARGUMENT 3

ARGUMENT 4

I. History of the Absolute Priority Rule in the Courts 4

II. Legislation and the *Case* Case 6

III. The 1978 Bankruptcy Code 9

CONCLUSION 14

TABLE OF AUTHORITIES

Page

CASES:

Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) 6, 9, 10

Consolidated Rock Products Co. v. DuBois, 312 U.S. 510 (1941) 8

Dewsnup v. Timm, 502 U.S. 410 (1992) 3, 9

Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad, 318 U.S. 523 (1943) 8

Mason v. Paradise Irrigation District, 326 U.S. 536 (1946) 8

Kansas City Terminal R. Co. v. Union Trust Co., 271 U.S. 4551 7

Marine Harbor Properties, Inc. v. Manufacturers Trust Co., 317 U.S. 78 (1942) 8

Matter of 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997) 3, 9

Louisville Trust Co. v. Louisville N.A. & C. R. Co., 174 U.S. 674 (1899) 4, 6

Northern Pacific Railway v. Boyd, 228 U.S 482 (1913) ... 5-7

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 14

United Savings Association v. Timbers of Inwood Forest Associates, 484 U.S. 365 (1988) 3

U.S. National Bank of Oregon v. Independent Insurance Agents of America, 113 S. Ct. 2173 (1993) 8

STATUTES:

11 U.S.C. § 1129 (a)(7) 12

11 U.S.C. § 1129 (b)(1) 12

11 U.S.C. § 1129(b)(2)(B)(ii) 12

11 U.S.C. § 1325(b)(2)(B) 12

12 U.S.C. § 1225(b)(1)(B) 13

Act of March 3, 1933, Ch. 204, § 77, 47 Stat. 1467 (1933) 6

Act of June 7, 1934, Ch. 424, § 77B, 48 Stat. 911 (1934) 6

LEGISLATIVE MATERIAL:

H.R. Rep. No. 595, 95th Cong., 1st Sess. 224 (1978)..... 11

MISCELLANEOUS:

Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963 (1989) 9

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Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stanford L. Rev. 69 6

Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93d Cong. (1973) 10

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1997

No. 97-1418

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari
to the United States Court of Appeals
for the Seventh Circuit

BRIEF OF THE AMICI CURIAE[1] AMERICAN BANKERS ASSOCIATION and CALIFORNIA BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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[1] No counsel for any party had any role in authoring this brief and no person other than amici curiae made any monetary contribution to its preparation or submission.

In accordance with the provisions of Rule 37.3(a) of the Supreme Court Rules, the American Bankers Association and California Bankers Association hereby respectfully submit this brief as amici curiae in support of the Petitioner. Both parties have consented to this filing and their written consents are filed together with this brief.

INTEREST OF THE AMICI CURIAE

The American Bankers Association is the principal national trade association of the banking industry in the United States. Its membership includes both commercial banks and thrift institutions located in each of the fifty states and the District of Columbia, and those institutions hold approximately ninety percent of the domestic assets of the industry.

The California Bankers Association is the principal state-based trade association for the lending industry in California, representing virtually all of the commercial banks and trust companies in that state.

Both associations frequently appear in litigation either as a party or as amicus curiae in cases raising issues of widespread importance to their members.

Litigation over the existence or nonexistence of a "new value exception" to the absolute priority rule in bankruptcy is of considerable concern to the Associations' members. Since virtually all debtors are insolvent, the costs of bankruptcy fall almost exclusively upon creditors, many of whom are represented by your amici. The "exception," if it is found to exist, (despite the fact that it can be found nowhere in the statutory language), will prove costly and disruptive, irreconcilable with the priorities Congress set down in the statute in favor of a vague standard that cannot

be administered in a fair and equitable manner, and ultimately transfers reorganization value from creditors (where Congress said it belongs) to existing owners.

SUMMARY OF THE ARGUMENT

The dispute among the lower courts and the commentators over the existence of a "new value exception" to the absolute priority rule in bankruptcy is often phrased in the form of a question whether the "new value exception *survived* passage of the Bankruptcy Code." *Matter of 203 N. LaSalle St. Partnership*, 126 F.3d 955, 963 (7th Cir. 1997)(emphasis added). To phrase the issue that way, however, is to overstate the alleged "exception's" pedigree, and thus to lead into errors in logical analysis and in application of this Court's precedents.

It is acknowledged that this Court is, and has been, "reluctant to accept arguments that would interpret the Code...to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). *See also United Savings Association v. Timbers of Inwood Forest Associates*, 484 U.S. 365, (1988). We ask the Court to do no such thing here. Prior to the enactment of the Bankruptcy Code in 1978, there never really was any fixed, definable or coherent "new value exception" to the absolute priority rule that could be or was applied in bankruptcy proceedings. The 1978 Code changed the nature of reorganizations so extensively that it is fair and accurate to say that prior to 1978, no "new value exception" had ever been or could have ever been applied to the kind of reorganization at issue in the present proceeding. Moreover, the legislative history of the 1978 Code is not devoid of any mention of a "new value

exception" to the absolute priority rule. Quite the contrary, there was a highly prestigious recommendation that Congress adopt an exception--a recommendation that Congress did not follow. Finally, Congress has carved out exceptions to the absolute priority rule in certain bankruptcy matters, thereby clearly showing that it knows how to do so when that is its intention. Those exceptions do not apply to the case at hand, and it must therefore be concluded that Congress did not intend for them to apply here.

ARGUMENT

I. History of the Absolute Priority Rule in the Courts

The "rule" that a debtor's creditors must be paid in full before the debtor's owners can retain any value has its genesis in railroad reorganizations of a century ago. In the absence of a federal bankruptcy statute at the time, such reorganizations took place in the form of equitable receiverships. In *Louisville Trust Co. v. Louisville N.A. & C. R. Co.*, 174 U.S. 674 (1899), a secured lender foreclosed on a railroad's property, thereby wiping out the interests of junior unsecured creditors, and yet apparently (and mysteriously), at least some equity ownership interest in the railroad was maintained by at least some stockholders. The unsecured creditors suspected collusion and attempted to challenge that outcome. The lower courts disallowed the challenge, but this is Court reversed, holding that "the stockholder's interest in the property is subordinate to the rights of creditors; first, of secured, and then of unsecured, creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of

prior rights of either class of creditors comes within judicial denunciation." *Id* at 684. "It is one thing for a bondholder who has acquired absolute title by foreclosure to mortgaged property to thereafter give of his interest to others, and an entirely different thing whether such bondholder, to destroy the interest of all unsecured creditors, to secure a waiver of all objections on the part of the stockholder and consummate speedily the foreclosure, may proffer to him an interest in the property after the foreclosure. The former may be beyond the power of the courts to inquire into or condemn. The latter is something which on the face of it deserves the condemnation of every court." *Id*. at 688.

The unsecured creditors having thus acquired rights that they could protect, it became necessary to determine the scope of those rights, still without benefit of applicable federal bankruptcy law. This Court began to do so in *Northern Pacific Railway v. Boyd*, 228 U.S. 482 (1913), in which a balance was struck among the desirability of continuing to operate a railroad (instead of dismantling it), the need for funds to do so (recognizing stockholders as the most likely source of those funds) and the unsecured creditors' rights. The Court said that it was not "necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock. If he declines a fair offer, he is left to protect himself as any other creditor of a judgment debtor; and having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it." *Id*. at 508.

But that, of course, left open the question of what constitutes a "fair offer." Two definitions were suggested

and debated: a rule of "absolute priority which recognized state law claims and did not permit owners to participate in the reorganized debtor unless those claims were satisfied in full, and a rule of "relative priority" which permitted owners to participate if earnings met certain levels and relative priorities among classes were observed.[2]

II. Legislation and the *Case* Case

Finally, Congress entered the picture. In 1933, it added Section 77 to the Bankruptcy Act of 1898, pertaining to railroad reorganizations (Act of March 3, 1933, Ch. 204, § 77, 47 Stat. 1467, 1474 (1933)). A year later, it added Section 77B to the Act, pertaining to other kinds of corporations (Act of June 7, 1934, Ch. 424, § 77B, 48 Stat. 911, 912 (1934)). While the two new sections of the law differed in some respects, both required that plans be "fair and equitable" as to each creditor and that all classes of affected creditors accept the plan by the required class vote. In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) this Court held that those words, "fair and equitable," were "words of art which...had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations." *Id.* at 115. Those "judicial interpretations" included, according to the Court, *Louisville Trust* and the "fixed principle" of *Northern Pacific Railway* (*id.* at 115-116) which the Court further described as "this rule of full or absolute priority." (id. at 117).

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[2] Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stanford L. Rev. 69, 82; 6A *Collier on Bankruptcy*, ¶ 11.06 (14th ed. 1978)

In *Case*, the lower courts had approved a reorganization plan in which old stockholders were entitled to some 23% of the reorganized company in return for the intangible value they would contribute to the reorganization: familiarity with the operation of the business, financial standing and influence in the community, and continuity of management. The Supreme Court agreed that the plan would have maintained the "relative priorities of the bondholders and stockholders." Id. at 112 and 119. But that was not the test, for even "the payment of cash by the stockholders for new stock did not [in *Kansas City Terminal R. Co. v. Union Trust Co.*, 271 U.S. 455] itself save the plan from the rigors of the 'fixed principle of the [*Northern Pacific v.*] Boyd Case, for in that case the decree was struck down where provision was not made for the unsecured creditor and even though the stockholders paid cash for their new stock. *Case*, *supra*, at 117.

Having rejected the "relative priorities" approach to adjusting the interests of owners, secured creditors and unsecured creditors in favor of a "full or absolute priority" rule, having accurately discussed the Court's own precedents holding that even cash contributions to a plan by old stockholders could not place their interests ahead of unsecured creditors, and having then rejected the plan of reorganization actually at issue in *Case*, the opinion of the Court then goes on to express a belief that a creditor is afforded "his full right of priority against the corporate assets " if the stockholder's participation is "based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder." *Id.* at 122.

Self-evidently, this brief discussion in the Court's opinion of the need for there to be a contribution in money or in money's worth in order for stockholders to participate in a reorganization plan is mere dicta.[3] The Court had no occasion to examine, in *Case* or thereafter, a plan in which such a "contribution" was made, and what might be the "circumstances" under which such a contribution might justify a re-ordering of priorities to the detriment of unsecured creditors senior to the interests of the stockholders, nor did it discuss how a "new Value" rule could co-exist with an *absolute* priority rule. And yet, this dicta is the entire source of the alleged "new value" exception to the absolute priority rule. No subsequent decision of this Court has upheld, as "fair and equitable," a plan providing for owner participation where senior claims were not satisfied in full.[4] Indeed, there do not appear to be any pre-Code published opinions at all in which the dicta was adopted so as to confirm a "new value" plan over the

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[3] This Court has cautioned that there is a "need to distinguish an opinion's holding from its dicta." *U.S. National Bank of Oregon v. Independent Insurance Agents of America*, 113 S. Ct. 2173, 2186 n. 11 (1993).

[4] *See Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510 (1941); *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78 (1942); *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad*, 318 U.S. 523 (1943). *See also Mason v. Paradise Irrigation District*, 326 U.S. 536 (1946) in which the courts did confirm a "new value" plan, but it was one in which the "new value" was contributed not by equity owners, but rather by a creditor.

objection of a dissenting creditor.[5] That being so, it was error for the Seventh Circuit to conclude that *Case* "for more than fifty years, the new value precept has been recognized as an important corollary or exception to the absolute priority rule," *LaSalle*, 126 F.3d at 965, so as to invoke the *Dewsnup* "rule" against implied *major* changes in pre-Code practice.

The absolute priority rule was not without its problems. Sections 77 and 77B of the Bankruptcy Act provided creditors with the right to vote by class on reorganization plans and required that a reorganization plan be fair and equitable as to *each* creditor. This effectively allowed tiny minority class members to block confirmation of plans by convincing the court that the plan was unfair or inequitable as to them.[6] The absolute priority rule thus lacked the flexibility that had been present in equity receiverships. That was a problem which Congress recognized and upon which it sought advice.

III. The 1978 Bankruptcy Code

In 1970, Congress created the Commission on Bankruptcy Laws of the United States, Pub. L. No. 91-354, charged it with studying the existing system and proposing any necessary changes to it. Among other

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[5] Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963, 1016 (1989); Klee, *Cram Down II*, 64 Am Bankr. L. J. 229, 241 (1990).

[6] This is precisely what happened in *Case*, in which the Supreme Court disallowed a plan of reorganization though it had been approved by majorities of 90% or more of the vote of various classes. *Case*, 308 U.S. at 111

things, the Commission specifically evaluated the judicially created absolute priority rule. When it made its report to Congress in 1973, it recommended that the rule be modified "by allowing stockholders to participate (in a reorganization plan) if their future contribution, i.e., continued management, is essential to the business." Report of the Commission of the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93d Cong. at 254-259 (1973). The Commission's draft of legislation designed to relax the absolute priority rule contained a Section 7-303 which, according to the explanatory notes, "allows the court to confirm, where the plan allows participation by ownership not permissible under the absolute priority test, if the participation is supported by, *e.g.*, continued management; this adopts the District Court's opinion which was reversed in *Case v. Los Angeles Lumber Products Co.*" *Id.* at 254.

While it is clear that the Commission recommended an exception to the absolute priority rule that is broader than the one at issue in this case, the fact of the matter is that Congress elected to codify the absolute priority rule when it enacted the Bankruptcy Code in 1978, and did so without making *any* exceptions to it, though it obviously knew there was a respectable constituency for exceptions.

In its Report on the Bankruptcy Code, the House of Representatives Committee clearly expressed its intent that the bill would closely adhere to the existing absolute priority rule:

> [T]he bill requires that the plan pay *any* dissenting class *in full* before *any* class junior to the dissenter may be paid *at all*. The rule is a partial application of the absolute priority rule now applied under Chapter X and requires a full

> valuation of the debtor as the absolute priority rule does under current law. The important difference is that the bill permits senior classes to take less than full payment in order to expedite or insure the success of reorganization.

H.R. Rep. No. 595, 95th Cong., 1st Sess. at 224 (1978) (emphasis added).

> The general principle of the subsection permits confirmation notwithstanding nonacceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. A dissenting class must be paid *in full* before *any* junior class may share under the plan.

Id. at 413 (emphasis added).

The Code's provisions for class voting and application of the "fair and equitable" standard literally reversed the statutory scheme of the superseded Bankruptcy Act. Previously, any class vote rejecting a proposed plan resulted in the rejection of the plan. But a class vote in favor of a plan triggered application of the fair and equitable standard with respect to each creditor. Now, to the contrary, a class vote in favor of the proposed plan of reorganization results in its approval, whereas a class vote against a plan triggers application of the fair and equitable requirement as to the class as a whole.

A "new value" exception under the old law would have provided some modicum of protection of *creditors* against holdouts, but under the new law, that is no longer necessary. Under the Code, unlike under the Act,

majority creditors no longer have need of such protection, since minority votes can, by statute, be overridden, without the need for some sort of imaginary "new value" exception to the absolute priority rule.

The current law's codification of the absolute priority rule for Chapter 11 cases such as this one clearly does not contain any exception to the rule. It provides that a plan can be accepted by each impaired class of claims or interests. 11 U.S.C. § 1129(a)(7). If the plan is not accepted within the meaning of the statute it may, nonetheless, be confirmed if it "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). "Fair and equitable," means, however, that "the holder of any claim or interest that is junior to the claims of such class will *not* receive or retain under the plan on account of such junior claim or interest *any* property. 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added).

By contrast, bankruptcy proceedings under Chapter 13 or under Chapter 12 do permit the retention of property by the debtor in return for monetary contributions of a sort. A Chapter 13 plan (concerning the adjustment of debts of an individual with regular income) can be confirmed over the objection of the holder of an allowed unsecured claim, even if the holder will not receive the full value of his or her claim, if "the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." 11 U.S.C. § 1325(b)(1)(B). Chapter 12 proceedings, pertaining to family farm bankruptcies, are governed by statutory language almost

identical to Section 1325. *See* 11 U.S.C. § 1225(b)(1)(B). Self-evidently, Congress knows how to preserve some of the junior interests of debtors, in derogation of the interests of senior unsecured creditors, when that is its intention. Yet it is equally self-evident that Congress chose not to do so with respect to Chapter 11 proceedings. It would have been a simple enough matter for Chapter 11 to have provided for confirmation of a plan over the objection of one or more classes of unsecured creditors if the equity owners were to make the type of monetary contribution that is expected of farmers and individuals in their respective proceedings. But Congress did no such thing. Instead, it required, in plain language, that objecting classes of senior creditors must be paid in full before junior classes (including equity owners) receive or retain *any* property.

CONCLUSION

Here, Bank of America, the sole creditor of its class, was not to be paid in full under the plan, but the equity owners were to retain an interest in the property. The bank objected to the proposed reorganization. As this Court has held, "[t]his was their prerogative under the Code, and courts applying the Code must effectuate their decision." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988). The Seventh Circuit failed to follow that directive, and its decision should be reversed.

Respectfully submitted,

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BRIEF OF THE AMERICAN COLLEGE OF REAL ESTATE LAWYERS AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Whether the "new value exception" to the "absolute priority rule" survived the codification of a modified absolute priority rule under § 1129(b)(2)(B)(ii) of the Bankruptcy Code.

2. Assuming, arguendo, the existence of a "new value exception" as articulated by this Court in *dicta* in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), whether the Seventh Circuit properly applied the exception.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iv

STATEMENT OF INTEREST OF AMICUS CURIAE ... 1

SUMMARY OF ARGUMENT 2

ARGUMENT 3

I. THE SO-CALLED NEW VALUE EXCEPTION OR NEW VALUE COROLLARY DID NOT SURVIVE THE ADOPTION OF THE BANKRUPTCY CODE 3

A. Confirmation of New Value Plans Prior to the Adoption of the Bankruptcy Code is an Illusion 4

B. Congress Rejected the New Value Exception When it drafted the Bankruptcy Code 5

C. The Language of the Bankruptcy Code Precludes the Confirmation of New Value Plans 7

II. THE NEW VALUE EXCEPTION AS ADOPTED BY THE SEVENTH CIRCUIT DISTORTS THE NEW VALUE COROLLARY AS ARTICULATED IN *DICTA* BY THIS COURT AND MOLDS IT INTO AN EXCEPTION THAT WOULD EFFECTIVELY ABROGATE THE ABSOLUTE PRIORITY REQUIREMENTS OF THE BANKRUPTCY CODE 10

TABLE OF CONTENTS – Continued

Page

A. The Seventh Circuit Ignores the Creditor Protection Prong of this Court's Articulation of the New Value Requirements 11

B. The Seventh Circuit Distorts the Other Prerequisites to New Value Articulated by this Court in *Case* 14

1. The Seventh Circuit distorts the requirement that the contribution be essential to the success of the undertaking 14

2. Reasonable equivalence is eliminated in no-equity situations 15

3. The new requirement of substantiality serves as a smoke screen for the failure to follow the *Case* prerequisites 17

III. THE APPLICATION OF THE SEVENTH CIRCUIT'S VERSION OF NEW VALUE TO SINGLE ASSET REAL ESTATE REORGANIZATIONS WOULD SERVE NO PUBLIC PURPOSE, ABROGATE THE PROTECTION FOR MORTGAGEES BUILT INTO THE BANKRUPTCY CODE, AND HAVE A SEVERE NEGATIVE IMPACT ON BORROWERS, LENDERS AND THE REAL ESTATE INDUSTRY 19

A. No Public Purpose 19

B. Abrogation of Mortgagee Protection 21

C. Negative Impact on the Real Estate Industry 23

CONCLUSION 24

TABLE OF AUTHORITIES

Page

CASES

Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) ..... *passim*

Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Associates, L.P. (In re Coltrex Loop Central Three Partners, L.P.), 138 F.3d 39 (2nd Cir. 1998) 3, 9

Dewsnup v. Timm, 502 U.S. 410 (1992) 7

In re 203 N. LaSalle Street Partnership, 126 F.3d 955 (7th Cir. 1997) ..... *passim*

In re 203 N. LaSalle Street Partnership, 190 B.R. 567 (Bankr. N.D. Ill. 1995) 8, 9, 16, 17

In re DRW Property Co. 82, 57 B.R. 987 (Bankr. N.D. Tex. 1986) 22

In re Pine Gate Associates, Ltd., 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976) 21, 22, 23

In re Snyder, 967 F.2d 1126 (7th Cir. 1992) 17

In re Woodbrook Associates, 19 F.3d 312 (7th Cir. 1994) 17, 18

Kansas City Terminal Railway Co. v. Central Union Trust Co., 271 U.S. 445 (1926) 11, 12, 14

Louisville Trust Co. v. Louisville, N.A. & C. Railroad Co., 174 U.S. 674 (1899) 12

Northern Pacific Railway Co. v. Boyd, 228 U.S. 482 (1913) 12, 16

TABLE OF AUTHORITIES – Continued

Page

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 16

State Mutual Assurance Co. of America v. KRO Associates (In re KRO Associates), 4 Bankr. Ct. Dec. (CRR) 462 (Bankr. S.D.N.Y. 1978) 21

Wright v. Union Central Life Insurance Co., 311 U.S. 273 (1940) 8

STATUTES

11 U.S.C. § 506(a) 21

11 U.S.C. § 1111 ..... 22, 23

11 U.S.C. § 1129(b) 6, 8, 9, 21, 22

48 Stat. 912 (Bankruptcy Act of 1898 § 77B) 6, 11

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Note, *The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule for Corporate Reorganizations*, 87 Harv. L. Rev. 1786 (1974) 5

TABLE OF AUTHORITIES – Continued

Page

Robert M. Zinman, *New Value and the Commission: How Bizarre!*, 5 Am. Bankr. Inst. L. Rev. 477 (1997) 13

Hearings on S. 2266 and H.R. 8200 Before Subcomm. on Improvements on the Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong. (1977) (statement of John J. Creedon, American Council of Life Insurance) 21

5 COLLIER ON BANKRUPTCY ¶ 506.03[4][e], at n.58 (Lawrence P. King et al. eds. 15th ed. rev. 1997) 9

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137 (1973) 5

S. Rep. No. 598 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787 22

BRIEF AMICUS CURIAE FOR AMERICAN COLLEGE OF REAL ESTATE LAWYERS IN SUPPORT OF THE PETITIONER

This brief is filed on behalf of the American College of Real Estate Lawyers as *amicus curiae*, in support of the Petitioner.[1]

STATEMENT OF INTEREST OF AMICUS CURIAE[2]

The American College of Real Estate Lawyers ("ACREL") is a nonprofit corporation, organized for the purpose of, inter alia, gathering together lawyers "to improve and reform real estate law and practice," (ACREL Articles of Incorporation at 2). ACREL's membership consists of over 800 attorneys from nearly every state and the District of Columbia who have concentrated their practice in real estate law for a period of ten years or more and law school professors specializing in the field of real estate law. In addition, members elected to ACREL must have demonstrated a willingness to devote time to improving real property law through writing, teaching or participation in professional association activities. ACREL's membership represents the entire spectrum of the real estate industry including borrowers,

[1] Counsel for a party did not author this brief in whole or in part. No person or entity, other than the Amicus Curiae, its members, or its counsel made a monetary contribution to the preparation and submission of this brief.

[2] Consent letters have been obtained from counsel for the parties, copies of which accompany this brief.

lenders, investors and developers. The case at bar involves a debtor whose single asset is an interest in commercial real estate that has declined in value to a point where the debtor's real estate is worth less than the amount of secured debt on the property. Whether the property securing the debt may be retained by the debtor's partners under a new value plan without paying the debt is an issue of significant concern to the real estate industry.

This brief supports the brief of the Petitioner in this case. Due to the background of the Amicus, its experience as counsel to lenders and borrowers, and its familiarity with the confusion, costs and consequences to the real estate industry arising from the ambiguities created by the issues before this Court, ACREL is in a unique position to offer its expertise concerning the adverse consequences of an affirmance of the decision below on the availability of financing for the acquisition, development, and financing of commercial real property in the United States.

SUMMARY OF ARGUMENT

This brief urges that the Seventh Circuit be reversed for the following reasons:

1. There is no new value exception or corollary to the fair and equitable requirement of the Bankruptcy Code. The new value principle as articulated in *dicta* prior to the adoption of the Bankruptcy Code was rejected by Congress in favor of a more flexible and

modified absolute priority rule that obviated the need for a new value principle.

2. The new value exception applied by the Seventh Circuit distorts the new value corollary articulated by this Court in its *Case v. Los Angeles Lumber* and represents a post-Code invention that contravenes the parameters set by Justice Douglas in *Case* and threatens the very existence of the absolute priority rule.

3. The Seventh Circuit's decision undermines the protection for real estate mortgages built into the Bankruptcy Code and threatens to have a severe negative impact on the real estate industry and the availability of real estate mortgage financing.

ARGUMENT

I. THE SO-CALLED NEW VALUE EXCEPTION OR NEW VALUE COROLLARY DID NOT SURVIVE THE ADOPTION OF THE BANKRUPTCY CODE.

This brief supports the conclusions and reasoning of the brief of the Petitioner, the dissent of Judge Kanne in the Seventh Circuit's opinion in *In re 203 N. LaSalle Street Partnership*, 126 F.3d 955, 970 (7th Cir. 1997), and the opinion of the Second Circuit in *Coltex Loop Central Three Partners, L.P., v. BT/SAP Pool C Associates, L.P. (In re Coltex Loop Central Three Partners, L.P.)*, 138 F.3d 39 (2d Cir. 1998), that there is no holdover new value exception or corollary to the absolute priority rule of the Bankruptcy Code.

A. Confirmation of New Value Plans Prior to the Adoption of the Bankruptcy Code is an Illusion.

The Seventh Circuit stated that "the new value corollary has long been ensconced in our bankruptcy practice," 126 F.3d at 965, and that it has been "a major source of new funding in reorganizations for the past fifty years." *Id.* at 966. From this predicate, the Seventh Circuit concluded that "one would expect that Congress would address deliberately such a significant issue of economic policy if it had determined to abolish it." *Id.* The problem with this conclusion is that its predicate is incorrect.

From the decision of this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), to the adoption of the Bankruptcy Code in 1978, there appears to be no published evidence that any "shareholder was ever able to convince a court that she contributed sufficient value to be able to retain an interest. Indeed, until the Code's adoption in 1978, no reported case seems to have adopted Justice Douglas' *dicta* as its holding." Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991). See also John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963, 1016 (1989), where Professor Ayer concludes, "Justice Douglas' supposed 'exception,' . . . is nowhere present as a rule of decision in Chapter X cases. New value under Chapter X, then, is an illusion."

Thus, there was no 50 year history of the new value exception being part of bankruptcy "practice." While the new value theory, as expressed in *dicta* by this Court in

Case, was known, the purported employment of that theory never became part of bankruptcy "practice" until *after* the adoption of the Bankruptcy Code.

B. Congress Rejected the New Value Exception When It Drafted the Bankruptcy Code.

In 1973, the Commission on the Bankruptcy Laws of the United States in its Report, concluded that under the absolute priority rule, debt and equity security holders are "frequently eliminated from participation in a reorganization by reason of the strict application of a statute designed primarily for their protection." H.R. Doc. No. 93-137, pt. 1, at 256 (1973). The absolute priority rule did not permit old equity to participate even with the agreement of all classes of creditors. The Commission's solution was to modify the absolute priority rule by permitting juniors to participate on the basis of a contribution "important to the operation of the reorganized debtor . . . under the plan" on a basis reasonably approximating the value of their contribution. H.R. Doc. No. 93-137, pt. 2, at 242. This proposal created a storm of criticism, *see, e.g.*, Victor Brudney, *The Bankruptcy Commission's Proposed "Modifications" of the Absolute Priority Rule*, 48 Am. Bankr. L.J. 305, 337 (1974); Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. Chi. L. Rev. 651, 669-70 (1974); Note, *The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule for Corporate Reorganizations*, 87 Harv. L. Rev. 1786, 1817 (1974), and was rejected by Congress.

In its place, Congress modified the absolute priority rule to limit its application to dissenting impaired classes

of creditors only,[3] thus freeing classes of creditors to admit junior interests by agreement. If this limited absolute priority had been in effect under the Bankruptcy Act, the *Case* plan would have been confirmed[4] and the issue that produced the new value *dicta* would never have arisen. Thus the Bankruptcy Code obviated the need for a new value corollary. Recognizing such a modification of the absolute priority rule, the dissent in *LaSalle* noted, "the pre-Code rationale for the new value exception makes little sense in today's Chapter 11 environment." 126 F.3d at 976. Congress considered a provision that would have incorporated new value into the Code (even including, it would seem, alternative forms of contribution, such as were proffered in *Case*), rejected it, and

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[3] Under the Bankruptcy Act, "Congress ha[d] required both that the required percentages of each class of security holders approve the plan and that the plan be found to be 'fair and equitable'. The former [was] not a substitute for the latter. . . . Accordingly the fact that the vast majority of the security holders ha[d] approved [a] plan [was] not the test of whether the plan [was] a fair and equitable one." *Case*, 308 U.S. at 114 (interpreting § 77B of the Bankruptcy Act, superseded by Chapter X). *Compare* Bankruptcy Code § 1129(b)(1) (applying the fair and equitable requirement only to dissenting, impaired classes).

[4] Though the *Case* plan had been approved by all classes of creditors, one individual creditor objected. The objecting creditor held an obligation with a face amount of $18,500, as compared to almost four million dollars in bonds outstanding. The objecting creditor's class approved the plan, and had the Bankruptcy Code been in effect, the plan would have been confirmed without employing the cramdown provision of § 1129(b).

enacted the compromise that allowed for participation by agreement.

The Seventh Circuit opined that Congress incorporated the new value exception when it drafted the Bankruptcy Code because, "[w]hen Congress amends the bankruptcy laws, it does not write 'on a clean slate.' " 126 F.3d at 965 (quoting *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992)). The facts, however, indicate either that new value was not on Congress's slate when the Bankruptcy Code was being considered, or that Congress had erased new value from whatever was on its slate before it began to write.

C. The Language of the Bankruptcy Code Precludes the Confirmation of New Value Plans.

The clear language of Bankruptcy Code § 1129(b)(2)(B) provides that a plan is not fair and equitable as to a dissenting impaired class of creditors if a junior interest, such as old equity,[5] retains an interest on account of its junior interest in the debtor. Yet the Seventh Circuit, in *LaSalle*, permits such a result.

The Seventh Circuit maintains that old equity's interest is not being retained "on account of" its former interest, but rather because the debtor's partners have made a bid for the enterprise, as a third party might, in the form of new value. 126 F.3d at 964. It stretches credulity to believe that old equity, in control of all the information about the property and with the *exclusive right* to retain

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[5] The term "old equity" as used herein refers to the stockholders, partners, or principals of the debtor.

an interest through a new value contribution under the plan, is not retaining an interest "on account of" its junior interest. Indeed, in *LaSalle* the Bankruptcy Court virtually admitted the motivation for the debtor's plan was based on old equity's junior interest in the partnership. It stated that the plan was submitted for the purpose of protecting the partners from tax losses arising out of their partnership interest in the debtor. *See In re 203 N. LaSalle Street Partnership*, 190 B.R. 567, 588 (Bankr. N.D. Ill. 1995) ("The debtor's partners thus seek to *retain their interests* not because of the intrinsic value of these interests, but because of the tax consequences that flow from their loss.") (emphasis added).[6]

Additionally, the language of the Bankruptcy Code precludes confirmation of new value plans in another way. Consistent with the decisions of this Court acknowledging that a secured creditor's property right in the collateral must be protected up to the value of the collateral, *see Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940) (where Justice Douglas stated that the Fifth Amendment required that safeguards "protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property"), Congress provided in § 1129(b)(2)(A)(i) that the secured claim be equal in amount and value to the value of the collateral as of the

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[6] The Seventh Circuit did not disturb the Bankruptcy Court's finding that the plan was being submitted on account of the tax liabilities arising from the partners interest in the debtor. In connection with the bank's claim that the tax motivation evidenced lack of good faith, the Seventh Circuit stated that "the desire to avoid significant tax liabilities, if legal, is a result consistent with the Bankruptcy Code." 126 F.3d at 969.

effective date of the plan. If old equity's new value contribution constitutes a bid for the property, it is a bid in excess of what was previously believed to be the value of the property. Section 1129(b)(2)(A) requires that the secured claim be equal to the value of the collateral and thus the secured claim must be increased to the higher value. As a result, at least in single asset situations, unless the senior secured class votes to include a participation by old equity, or, as suggested in *Coltex*, the property is auctioned off to the highest bidder, *see* 138 F.3d at 44-45, the language of the Bankruptcy Code would preclude confirmation of a plan, such as that proposed in *LaSalle*, under which the property is to be acquired by old equity over the objection of the secured creditor for less than the full amount of the mortgage balance.[7]

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[7] In *LaSalle*, the Bankruptcy Court attempted to deflect this argument by finding that the bid was not based on the "intrinsic" value of the real estate "but because of the tax consequences that flow from their loss." 190 B.R. at 588. However the price paid for property is normally considered determinative of value without an examination of the motivations of the purchaser. "[I]f the collateral is actually sold during the course of the bankruptcy proceedings or pursuant to a confirmed plan, the consideration received from the sale will almost always resolve the question of value." 5 COLLIER ON BANKRUPTCY ¶ 506.03[4][a] at n.58 (Lawrence P. King et al. eds. 15th ed. rev.1997). Indeed, in *LaSalle*, the bankruptcy court itself, in referring to what would be paid on the deficiency claim, stated that the creditor will receive "50% of the net *value* of the property either as *realized in a sale*, or as appraised at the time of any refinancing." 190 B.R. at 576 (emphasis added). The price paid indicates value. The motivation of the purchaser is irrelevant. If the purchaser's motivation for buying were a consideration in determining value, every purchase price could be attacked as not representing the value of the property since

It is thus clear from the language of the Bankruptcy Code and the intent of Congress that under the Bankruptcy Code, a plan granting an interest to old equity cannot be imposed on a dissenting, impaired class of creditors that has not been afforded absolute priority, whether or not new value is contributed.

II. THE NEW VALUE EXCEPTION AS ADOPTED BY THE SEVENTH CIRCUIT DISTORTS THE NEW VALUE COROLLARY AS ARTICULATED IN *DICTA* BY THIS COURT AND MOLDS IT INTO AN EXCEPTION THAT WOULD EFFECTIVELY ABROGATE THE ABSOLUTE PRIORITY REQUIREMENTS OF THE BANKRUPTCY CODE.

As discussed above, this brief argues that no new value principle survived the adoption of the Bankruptcy Code. Even if this Court should conclude that new value is still viable, the Seventh Circuit should be reversed because the supposed "new value corollary" applied by the Seventh Circuit is not the corollary to absolute priority articulated by this Court in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939).

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each purchaser brings its own baggage to the bidding table, whether it be the purchaser's tax or financial situation, architectural preferences, availability of funds for investment, or individual preferences. Valuation based on motivation would be an invitation to manipulation and litigation.

A. The Seventh Circuit Ignores the Creditor Protection Prong of this Court's Articulation of the New Value Requirements.

In *Case*, this Court struck down a plan under which old equity attempted to circumvent the requirement that a plan had to be "fair and equitable," which term requires that interests in the debtor be distributed on the basis of "absolute priority." 308 U.S. at 115-17. The *Case* plan, approved by all classes of creditors, would have allowed old equity to retain an interest in the debtor based on a promised contribution of expertise even though creditors were not fully compensated.[8]

This Court noted that it had previously stated that creditors could be protected "through other arrangements, *which distinctly recognize their equitable right to be preferred to stockholders against the full value of all property belonging to the debtor . . .*" 308 U.S. at 117 (quoting *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 454 (1926)) (emphasis added). Justice Douglas stated that where the *necessity* for funds exists and old equity makes a fresh contribution "and receive[s] in return a participation *reasonably equivalent* to their contribution," the creditors cannot object on the ground that they were not accorded their "full right of priority against the corporate assets." *Id.* (emphasis added).

The *dicta* in *Case* permitted old equity to participate only if certain conditions were met. Foremost among those conditions was that the creditors' "full right of

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[8] *Case* was decided under § 77B of the Bankruptcy Act of 1898 (48 Stat. 912).

priority" against the debtor's assets be preserved.[9] 308 U.S. at 122. Old equity could not participate "at the expense of the prior rights . . . of creditors." *Id.* at 116. It is this creditor protection prong of the *Case dicta* that the Seventh Circuit, and cases adhering to its view, ignore. In *LaSalle*, old equity was allowed to retain valuable property at the expense of the unpaid mortgagee, which received only 16% on its deficiency claim. This would

[9] This principle was articulated in many ways in the language of the decision. For example: (i) Justice Douglas, quoting the decision in *Louisville Trust Co. v. Louisville, N.A.&C. Railroad Co.*, 174 U.S. 674, 684 (1899), stated that "any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation." 308 U.S. at 116; (ii) *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482, 508 (1913) was quoted as support for the proposition that "value, whether it was present or prospective, for dividends or only for purposes of control. . . . was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever." *Id.*; (iii) Justice Douglas quotes *Kansas City Terminal Railway Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926), for the proposition that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation," 308 U.S. at 120, and concludes that the proposed plan did not "recognize the 'equitable right' of the bondholders to be preferred to stockholders against the full value of all property belonging to the debtor corporation . . . since the full value of that property is not first applied to claims of the bondholders before the stockholders are allowed to participate" *Id.*; and quoting *Kansas City Terminal* again, Justice Douglas stated that when "assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances." 308 U.S. at 121.

hardly seem to accord the creditor its "full right of priority."[10]

Thus, by not affording the creditor its full right of priority, the *LaSalle* debtor's plan did not meet this requirement of the new value corollary to the absolute priority rule, was not fair and equitable, and should not have been confirmed over the objection of an impaired class of creditors.

[10] How the standards of the *Case* dicta can be achieved has been the source of much controversy. Professors Ayer and Markell apparently believe that the requirements of the *Case dicta* can never be achieved. *See* Ayer, *supra*, at 1016; Markell, *supra*, at 92-93. However other theories have been articulated that would seem to achieve in large measure the balance Justice Douglas was looking for. For example, it has been suggested that the interest of the new value contributor be determined based on a sharing of the equity. Under this theory, the enterprise value prior to the infusion of new value remains with the creditors. The interest of old equity will be determined by comparing the capital infusion to the value of the enterprise after the infusion. Since this theory does not deal with the issue of how control would be valued (especially significant in an enterprise with little or no value) an alternative theory, based on the proposition that the entire value of the enterprise, including control, belongs to the unpaid creditors and thus the interest of old equity should be measured by comparison to the amount of unpaid debt. These theories are discussed in greater detail in Robert M. Zinman, *New Value and the Commission: How Bizarre!*, 5 Am. Bankr. Inst. L. Rev. 477, 487-90 (1997). No attempt at meeting the "full right of priority" prong of Justice Douglas' *dicta* was even attempted in *LaSalle*.

B. The Seventh Circuit Distorts the Other Prerequisites to New Value Articulated by this Court in *Case*.

As discussed above, under the *dicta* in *Case*, a plan in which old equity retains an interest might be confirmed upon a contribution of new value in the form of money or money's worth *only if* the full priority rights of creditors are preserved. In order to preserve those priority rights, Justice Douglas stated that certain prerequisites must be met. First, the new value must be necessary or " *'essential to the success of the undertaking'*," 308 U.S. at 121 (quoting *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926)) (emphasis added); and second, the contribution must be "reasonably equivalent in view of all the circumstances to the participation of the stockholder." 308 U.S. at 122. In *LaSalle*, the requirements of necessity and reasonable equivalence have been so distorted that in reality they no longer are prerequisites to confirmation of a new value plan. In large measure, they have been dissolved in a new amorphous requirement of substantiality that seems to have no objective standards to determine if it has been met.

1. The Seventh Circuit distorts the requirement that the contribution be essential to the success of the undertaking.

When Justice Douglas referred to the "necessity, at times, of seeking new money 'essential to the success of the undertaking'," 308 U.S. at 121 (quoting 271 U.S. at 455), he was referring to the necessity for funds to continue the operation of the enterprise, the production of its

product, the provision of its services, and the employment of its workers. In single asset real estate cases, such as *LaSalle*, it is difficult to find this necessity. There is no business to be continued, no product to be produced, and no service to be performed that will not be continued, produced, or performed by the new owner of the real estate.

Confronted with the fact that funds were not essential to the success of the undertaking in *LaSalle*, the Seventh Circuit distorted the necessity requirement to mean essential for confirmation of the debtor's plan! ("The infusion of new capital was necessary for the successful implementation of the plan." 126 F.3d at 967). Since new value is always proposed by the debtor to enable old equity to keep the property under the plan, this switch in the meaning of "necessary" would result in virtually every new value plan meeting the necessity requirement. In effect the Seventh Circuit is saying that the debtor may wipe out the creditors' interests if that is the only way old equity can retain the property while leaving the debtor's debts unpaid. This effectively reads "essential to the success of the enterprise" out of the prerequisites for new value plan confirmation.

2. Reasonable equivalence is eliminated in no-equity situations.

Under the prerequisite of reasonable equivalence, old equity may not receive more than the reasonable equivalence of its contribution. In single asset cases, the debtor usually has no equity in the property (the property value is equal to or lower than the mortgages encumbering it),

as was the case in *LaSalle* where the asset was valued at $54.5 million but was encumbered by Bank of America's mortgage of $93 million, leaving a deficiency claim of $38.5 million, 84% of which was wiped out under the debtor's new value plan. In the past, debtors have argued that retention of the property by old equity does not deprive the creditor of its full right of priority because what the debtor proposes to retain is worthless. This Court has clearly rejected this "no-value" argument. In *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482, 508 (1913), this Court stated that "control" itself was an asset that constituted value and that such value belonged to the creditors, not old equity. This Court again, in 1988, reaffirmed that determination in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), stating that "we join with the consensus of authority which has rejected this 'no value' theory." *Id.* at 207.

The *LaSalle* bankruptcy court seemed to have no difficulty in ignoring these decisions when it employed the no-value theory as the basis for determining that the contribution met the reasonable equivalence standard. The Bankruptcy Court stated that "the contribution is easily the equivalent of the interests retained by the debtor's partners. Indeed, on the market, those interests are worthless." 190 B.R. at 588. The Seventh Circuit merely acknowledged that the Bankruptcy Court had determined that the contribution was "reasonably equivalent to the interest retained" and failed to discuss how or on what basis the requirement had been met, apparently agreeing with the Bankruptcy Court's approach. *See* 126 F.3d at 967.

LaSalle, then, reads the "reasonably equivalent" prerequisite out as a condition to new value plan confirmation, at least in those cases where the debtor has no equity in the property.

3. The new requirement of substantiality serves as a smoke screen for the failure to follow the *Case* prerequisites.

When the new value principle was rediscovered and revised after the adoption of the Bankruptcy Code, a new prerequisite was added by the courts, which required that the contribution be substantial. The Seventh Circuit referred to this requirement as a corollary of the requirement of necessity. *See In re Snyder*, 967 F.2d 1126, 1131 (7th Cir. 1992). Other decisions of the Seventh Circuit have seen the substantiality requirement as a summary of all other factors, which means that if the contribution is substantial, it meets at least the necessity and reasonable equivalence requirements. This "substitute" theory is articulated in the bankruptcy court decision in *LaSalle*, where the court understood the decision in *In re Woodbrook Associates*, 19 F.3d 312, 320 (7th Cir. 1994), to imply that "substantiality serves as something of a summary of the other factors." 190 B.R. at 587. This conclusion is obviously a non-sequitur of major proportions. While a nominal contribution might be an indication that the contribution is not necessary for the success of the enterprise, it does not follow that a large contribution is necessary. As for reasonable equivalence, one cannot consider whether a contribution of any size is reasonably equivalent in the abstract; one must first determine the value of

the interest to which the contribution is supposed to be reasonably equivalent.

The unique aspect of the substantiality requirement is that there appear to be no standards to determine whether it has been met. The Seventh Circuit in *LaSalle* quotes other decisions in that Circuit stating that the contribution cannot be "merely nominal, or gratuitous." 126 F.3d at 967 (citations omitted). Beyond that, " '[w]hether the infusion of new capital is 'substantial' is more a common sense determination than a mathematical calculation when the debtor comprises only a single real estate asset which is fully encumbered.' " *Id.* (quoting *Woodbrook*, 19 F.3d at 320). This common sense determination is made by looking to whether the contribution is "real and necessary to the successful implementation of the *plan*." *Id.* (emphasis added). The Seventh Circuit approved the Bankruptcy Court's determination that the amount was substantial in both absolute terms, *see* 126 F.3d at 967 (comparing contribution with dollar amounts approved in other cases), and its impact on the case. *See id.* (measuring the contribution as a percentage of the unsecured debt in this case as compared to others).

The circularity of the Seventh Circuit's discussion of substantiality begins with reading into the Bankruptcy Code the pre-Code *dicta* of this Court, strictly limited by prerequisites. The next step is to incorporate a *new* prerequisite of substantiality and determine that it serves as a summary of the prerequisites in the pre-Code *dicta*, thus permitting the court to ignore or give scant attention to them. Then the court determines that whether substantiality is met is a subjective determination with virtually no objective standards. The result appears to be that only

the words "new value" survived the adoption of the Bankruptcy Code but not the standards by which the new value corollary would be met.

- By ignoring the creditor priority prong of this court's new value *dicta*, and then distorting both the necessity and reasonable equivalence prerequisites and subordinating them to a new amorphous requirement of substantiality, the Seventh Circuit has converted the *Case corollary* to a wide *exception* to the absolute priority rule that threatens to consume the rule itself. We respectfully urge that the Seventh Circuit be reversed.

III. THE APPLICATION OF THE SEVENTH CIRCUIT'S VERSION OF NEW VALUE TO SINGLE ASSET REAL ESTATE REORGANIZATIONS WOULD SERVE NO PUBLIC PURPOSE, ABROGATE THE PROTECTION FOR MORTGAGEES BUILT INTO THE BANKRUPTCY CODE, AND HAVE A SEVERE NEGATIVE IMPACT ON BORROWERS, LENDERS AND THE REAL ESTATE INDUSTRY.

A. No Public Purpose.

The confirmation of new value plans is often urged as a matter of public policy on the ground that the funds are needed to keep the debtor in business, preserve the going concern value, keep people employed, and preserve the performance or production of needed services or products. Whether or not such arguments make sense in the case of a manufacturer or service provider, these laudable objectives are wholly inapplicable to single asset real estate cases. In the single asset real estate transaction the operation of the real estate will continue no matter

who is the owner of the property. It is inappropriate to say that the "reorganization will fail" if there is no infusion of new value. The only thing that may fail is the attempt by old equity to keep the debtor's property without paying its just debts.[11]

If the debtor's plan cannot be confirmed and the property goes to foreclosure, the mortgagee or other purchaser at the sale will operate the property. The question is not whether the business will continue; the question is only who will own the property – the debtor's old equity who have not paid the debtor's obligations to creditors, or the creditors who have not been paid. The decision below opts for the former, with old equity given the property and 84% of the creditor's deficiency claim wiped out. No public purpose can be served by such a result.

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[11] The Seventh Circuit does not appear to recognize the distinction between a corporate entity that is an active business and a single asset real estate partnership, which does not have an active business but is primarily a vehicle for owning real estate. In concluding that new value survived the adoption of the Bankruptcy Code, the court states that to conclude otherwise would assume that Congress, without addressing the issue, made a decision "affecting the economic health, and indeed the continued existence, of many *corporate entities*." 126 F.3d at 966 (emphasis added). While there are, of course, some corporations that are single asset entities, the purpose of the court's example is to describe the effect of bankruptcy on going businesses, seemingly without appreciation of the fact that most single asset entities are partnerships like LaSalle, without a going business to be concerned about.

B. Abrogation of Mortgagee Protection.

Section 1129(b)(2)(B)(ii) of the Bankruptcy Code prohibits confirmation of a plan over the objection of an impaired class of unsecured creditors if old equity is permitted to retain an interest in the property on account of its junior interest. A major reason for this provision was to overcome the so-called *Pine Gate* line of cases that treated nonrecourse mortgagees as the Seventh Circuit now treats all mortgagees. In *In re Pine Gate Associates, Ltd.*, 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976), and its progeny, decided under chapter XII of the former Bankruptcy Act, the bankruptcy courts allowed debtors to retain the mortgaged property upon payment to the non-recourse mortgagee of the depressed (due to the mid-70's recession) value of the collateral.[12] In direct response to the perceived inequity of the *Pine Gate* line of cases, Congress was asked to restore absolute priority to real estate arrangements under the new chapter 11 of the Bankruptcy Code. *See, e.g., Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in the Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong. 853, 855-56, 864-76 (1977) (statement of John J. Creedon, American Council of Life Insurance).

Congress enacted a package of protection insuring that the mortgagee may have an unsecured claim for the deficiency, see 11 U.S.C. § 506(a), and providing absolute

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[12] In *State Mutual Assurance Co. of America v. KRO Associates (In re KRO Associates)*, 4 Bankr. Ct. Dec. (CRR) 462, 463, 470 (Bankr. S.D.N.Y. 1978), there were approximately $14 million in mortgages on the property. The court, using a 20% capitalization rate, found the value of the property to be $895,000.

priority for each dissenting impaired class of creditors, including the unsecured class. *See* 11 U.S.C. § 1129(b)(2). It was this absolute priority for the unsecured class, including the mortgagee's deficiency claim, that provided the protection afforded by Congress. If the unsecured class rejected the plan (and normally in single asset cases the mortgagee's deficiency claim is the only major unsecured claim) the debtor would not be able to retain the property without paying the creditors. Such a plan could not be confirmed.

New value as applied in *LaSalle* and many post enactment Bankruptcy Code cases would abrogate this protection by essentially restoring the *Pine Gate* rule – in a much more sinister form. In both situations the debtor would keep the property. The difference is that under *Pine Gate*, the mortgagee would receive an immediate payment of cash equal to the court determined value of the collateral, whereas in the new value cases after the enactment of the Bankruptcy Code, the mortgagee could receive only a mortgage with a face amount equal to the court determined value of the collateral. This retention of the property by old equity when portions of, or all of, the mortgagee's deficiency claim is wiped out is clearly the opposite of what Congress intended. *See* S. Rep. No. 95-598, at 65 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5851 (stating that a precursor of present § 1111(b), which affords a deficiency claim to nonrecourse mortgagees, "answers the nonrecourse loan problem and gives the creditor an unsecured claim for the difference between the value of the collateral and the debt in response to the decision in" *Pine Gate*); *see also In re DRW Property Co. 82*, 57 B.R. 987, 990 (Bankr. N.D. Tex. 1986) (stating Congress

enacted § 1111(b) "to alleviate the *Pine Gate* problem and to attempt to restore the benefit of the bargain to the nonrecourse secured creditor").

It should be apparent that new value, as interpreted by the Seventh Circuit, would undo the absolute priority protection afforded by Congress to mortgagees. This would represent a major adverse change in the treatment of mortgages in bankruptcy.

C. Negative Impact on the Real Estate Industry.

The decision below will have a severe adverse impact on the real estate industry. Literally billions of dollars have been loaned to real estate developers by institutions, including insurance companies and pension plans that insure and protect millions of ordinary citizens, on the strength of real property collateral and the protection for realization on that collateral built into the Bankruptcy Code. Mortgage loans are securitized, rated and sold to investors seeking the security of the mortgage collateral. These purchasers include individual investors and pension funds, as well as institutions investing policyholders' funds and deposits from individuals and corporations, all of whom make these investments based on the ability to realize the benefit of the bargain if there is a default in the income flow.

The decision below can only result in the severe reduction of the availability of funds for real estate development from institutions and from the public, and tighter credit standards and higher interest rates for those funds that are available or those securities that are sold. *LaSalle* not only threatens existing mortgage debt held by

lenders, but also threatens the future of the real estate and real estate securities industry.

The Bankruptcy Code was carefully drafted by Congress to balance the interests of debtors and creditors and provide for the efficient administration of bankruptcy cases in the United States. If Courts are permitted by judicial legislation to undermine the foundations of the protection afforded to real estate mortgagees, the real estate industry and the national economy, will be severely and adversely affected.

CONCLUSION

For all the reasons set forth herein, the American College of Real Estate Lawyers respectfully urges that the decision of the Seventh Circuit be reversed.

Respectfully submitted,

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION,
Petitioner,
v.
203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF OF RONALD MANN, ROBERT K. RASMUSSEN, BARRY ADLER, JAMES BOWERS, DANIEL L. KEATING, ERIC A. POSNER, ALAN SCHWARTZ, DAVID A. SKEEL, JR., AND JAMES J. WHITE, AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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31pp

TABLE OF CONTENTS

	Page
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT:	
I. THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE REQUIRES REVERSAL	5
A. The Proposed Plan Grants Prepetition Equity Holders Property "On Account Of" Their Status As Equity Holders	5
B. The Court of Appeals' Reading of Section 1129(b)(2)(B) Is Erroneous	10
C. Congress's Action in Enacting the Bankruptcy Code Implies That There Is No New Value Exception to the Absolute Priority Rule	13
II. PRIOR PRACTICE UNDER THE BANKRUPTCY ACT COMPORTS WITH THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE	16
III. SOUND BANKRUPTCY POLICY SUPPORTS THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE	21
CONCLUSION	26

TABLE OF AUTHORITIES

Cases: Page

Bonner Mall Partnership, In re, 2 F.3d 899 (9th Cir. 1993) 12, 14, 16, 24, 25
Bryson Properties, In re, 961 F.2d 496 (4th Cir. 1992) 11
Case v. Los Angeles Lumber, 308 U.S. 106 (1939) .. 3, 18, 20
Coltex Loop Central Three Partners, L.P., In re, 138 F.3d 39 (2d Cir. 1998) 11
Dewsnup v. Timm, 502 U.S. 410 (1992) 17
Edmonds v. Compagnie Generale Transatlantique, 443 U.S. 256 (1979) 18
Kansas City Terminal Railway Co. v. Central Union Trust Co., 271 U.S. 445 (1926) 15
Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351 (7th Cir. 1990) 11, 18
Mason v. Paradise Irrigation Dist., 326 U.S. 436 (1946) 18-19
Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 (1986) 17
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 2, 5, 6
Synder, In re, 967 F.2d 1126 (7th Cir. 1992) 17

Statutes:

Act of July 7, 1952, ch. 579, §§ 35, 43 & 50 20
11 U.S.C. § 101(16) 7
11 U.S.C. § 101(17) 7
11 U.S.C. § 506(a) 23
11 U.S.C. § 621(2) (1976) 3
11 U.S.C. § 1121 ..... 2, 7
11 U.S.C. § 1121(c) 7
11 U.S.C. § 1123(a)(1) 22
11 U.S.C. § 1126 22
11 U.S.C. § 1129(a)(7) 22
11 U.S.C. § 1129(b)(2)(A) 22
11 U.S.C. § 1129(b)(2)(B) 2, 10, 22
11 U.S.C. § 1129(b)(2)(B)(ii) 5

TABLE OF AUTHORITIES—Continued

Miscellaneous: Page

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Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. Chi. L. Rev. 651 (1974) 25
124 Cong. Rec. 32408 (Sept. 28, 1978) 15
Robert G. Hansen & Randall S. Thomas, *Auctions in Bankruptcy: Theoretical Analysis and Practical Guidance*, 18 Int'l Rev. L. & Econ. 159 (1998) 12
House Rep. No. 2320, 82d Cong., 2d Sess. (1952) .. 20
House Rep. No. 95-595, 95th Cong., 1st Sess. (1977) 15, 22
H.R. 8200, 95th Cong., 2d Sess. § 1129(b)(2)(B)(iv) 15
Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97 Com. L.J. 297 (1992) 21, 25
Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 Marq. L. Rev. 159 (1987) 5
Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 Penn. L. Rev. 135 (1990) 4, 25
Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (Pt. 2), 57 Am. Bankr. L.J. 263 (1988) 4-5

TABLE OF AUTHORITIES—Continued

	Page
Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 Wisc. L. Rev. 729	8, 9
Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 Mich. L. Rev. 159 (1997)	24
Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69 (1991)	11
Random House Dictionary of the English Language (2d ed. 1987)	6
Harold Gill Reuschlein & William A. Gregory, The Law of Agency (2d ed. 1989)	7
Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 Mich. L. Rev. 47 (1997)	18
S.2266, 95th Cong., 2d Sess. § 1130(a)(9)(A)	14
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J. Ronald Trost, The New Federal Bankruptcy Code (1979)	17

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203 NORTH LASALLE STREET PARTNERSHIP,
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INTEREST OF *AMICUS CURIAE* [1]

With the written consent of the parties, reflected in letters on file with the Clerk, the undersigned bankruptcy law scholars submit this brief as *amicus curiae*, pursuant to Rule 37 of the Rules of this Court.

[1] In accordance with Supreme Court Rule 37.6, the law professors appearing as *amicus curiae* represent that no party other than themselves authored this brief in whole or in part, and no person or entity, other than Vanderbilt Law School, which paid for the printing of this brief through Professor Rasmussen's research acount, has made a monetary contribution to the preparation or submission of this brief.

Amici are teachers and students of bankruptcy law. They are Ronald Mann, Assistant Professor of Law, University of Michigan Law School (counsel of record), Robert K. Rasmussen, Professor of Law, Vanderbilt University Law School, Barry Adler, Professor of Law, New York University School of Law, James Bowers, Professor of Law, Louisiana State University Law Center, Daniel L. Keating, Dean and Professor of Law, Washington University School of Law, Eric A. Posner, Professor of Law, University of Chicago Law School, Alan Schwartz, Professor of Law, Yale Law School, David A. Skeel, Associate Professor of Law, Temple University School of Law, and James J. White, Professor of Law, University of Michigan Law School. They submit this brief *pro se*, representing no institution, group, or association. Their sole purpose is to offer what assistance they can to this Court as it considers and decides this important case about the interpretation of the Bankruptcy Code.

SUMMARY OF ARGUMENT

1. This Court need not venture beyond the language of the Bankruptcy Code to resolve the issue before it. When, as in this case, a class of unsecured creditors both is not paid in full and dissents from a proposed plan of reorganization, no prepetition equity holder may "receive or retain under the plan on account of [its] interest any property." 11 U.S.C. § 1129(b)(2)(B). All agree that the plan at issue in this litigation gives "property" to the prepetition equity holders. See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-208 (1988). On any sensible reading of the phrase "on account of," this plan allocates property to equity holders "on account of" their status as equity holders. First, it is only because they are equity holders that they have a right, often (as in this case) the exclusive right, to propose a plan of reorganization. See 11 U.S.C. § 1121. Second, under the plan which the equity holders proposed in this case, only equity holders receive the option to purchase a stake in the reorganized firm over the objections of the unsecured creditors. Under the statutory language, it is evident that the equity holders whose plan reserves this right to themselves receive equity in the reorganized firm "on account of" their status as prepetition equity holders. Accordingly, the Code expressly prohibits confirmation of this plan.

2. Prior practice under the old Bankruptcy Act does not justify a contrary conclusion. The Bankruptcy Act, superseded in 1979 by the Bankruptcy Code, required, in relevant part, that a plan of reorganization be "fair and equitable." 11 U.S.C. § 621(2) (1976). This Court interpreted this prior language to require that senior interests have absolute priority over junior interests. Junior interests could not be paid anything over the dissent of an unpaid senior creditor. While *dicta* in the 1939 decision of *Case v. Los Angeles Lumber*, 308 U.S. 106 (1939), intimated that there might have been an exception to this rule where old equity holders contributed money or money's worth to the reorganization effort, neither this Court nor any lower court applying the Act ever held that such an exception in fact existed. Bankruptcy law under the Act thus did not contain a well-developed "new value" exception to the absolute priority rule.

Even had the *dicta* in Case developed into settled law, there would be no new value exception under the Code. The new value exception suggested in *Case* applied only if all classes of creditors approved the plan of reorganization, and an *individual*, outvoted, creditor sought to block confirmation by invoking the absolute priority rule. The language of the new Code plainly states that only a dissenting *class* of creditors can invoke the absolute priority rule. Individual creditors whose class consents to the plan cannot veto the plan on the grounds that junior interests are receiving property. Thus, in every situation where the putative new value exception would have allowed confirmation of a plan under prior law—viz., where all creditor classes consent and a new contribution is made by prepetition equity holders—the Code now in fact requires confirmation. Appending the new value exception to cur-

rent law would grant equity holders a right they never possessed under the theory of the *Case* dicta, a right to retain an interest in the debtor over the objection of a class of unpaid creditors.

3. The plain language of the Code reflects a coherent view of bankruptcy policy. The Code puts the reorganization decision in the hands of the creditors, who are the residual owners of the insolvent firm. Here those creditors have decided to reject the plan proposed by the prepetition equity holders. It is important to emphasize that the question is not whether prepetition equity olders can participate in the reorganized debtor, they can. The question is who gets to decide—the debtor and the bankruptcy court, or the creditors. The Code leaves this decision to the creditors—those entities whose money is at stake in the reorganization decision. The creditors, via class voting, can decide to cede property to prepetition equity holders. If the equity holders cannot convince the creditors that such a concession is in the creditors' own interest, it makes little sense to allow a bankruptcy court to substitute its opinion for that of the creditors.

ARGUMENT

It is important to identify precisely what is at stake in this case. The question is not whether prepetition equity holders can receive property in the reorganization of a firm in Chapter 11. They can. Numerous plans of reorganization have been confirmed which allow for such participation. For example, a study of the reorganization of 30 insolvent, publicly traded firms, found that prepetition equity holders retained an interest in the reorganized firm in 21 of these cases, always with the consent of the unsecured creditors. See Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held* Companies, 139 U. Penn. L. Rev. 125, 143 (1990).[2] Rather, the

[2] For other studies reporting similar results, see Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under*

question before the Court is whether a bankruptcy court can approve a plan which grants the prepetition equity holders an interest in the reorganized firm over the objeciton of a class of unsecured creditors. The language, history and policies of the Bankruptcy Code dictate that it cannot.

I. THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE REQUIRES REVERSAL

A. The Proposed Plan Grants Prepetition Equity Holders Property "On Account Of" Their Status As Equity Holders

This Court has previously explained that the absolute priority rule of the Bankruptcy Code "provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan." *Ahlers*, 485 U.S. at 202 (internal quotation marks and citation omitted). This case presents the issue of whether there is an unwritten exception to this rule of absolute priority—a so-called "new value" exception—which allows the bankruptcy court to approve, *over the unsecured creditors' objection*, a reorganization plan that allows prepetition equity holders to retain an interest in the reorganized firm if they make a new capital contribution to the reorganizing firm.

The Code provides that a bankruptcy court can approve a proposed plan of reorganization over the dissent of a class of unsecured creditors only if "the holder of any claim or interest that is junior to the claims of [the objecting] class will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii). The justification for

Chapter 11 of the Bankruptcy Code? (Pt. 2), 57 Am. Bankr. L.J. 247, 263-66 (1983); Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 Marq. L. Rev. 159, 165-183 (1987).

this requireemnt is readily apparent. When a firm is insolvent, the creditors' claims exceed the value of the firm's assets, and they are thus entitled to receive the entire value of these assets. A plan of reorganization which gives value to subordinate creditors or equity holders while more senior creditors are not being paid in full presents the danger that the lower class is receiving property which rightfully belongs to the senior class. Accordingly, the Code's absolute priority rule allows the senior creditors, as a class, to block that misappropriation.

The plan in this case gives the current equity holders the exclusive right to retain the equity interest in the reorganized firm in exchange for cash payments. Pet. App. 139a. This Court's decision in *Ahlers* makes clear that the interest that the equity holders are retaining is "property" as that term is used in the Code. See *Ahlers*, 485 U.S. at 208 (quoting *Northern Pacific R. Co. v. Boyd*, 228 U.S. at 508) (regardless of the current value of the reorganized firm, "a retained equity interest is a property interest to 'which the creditors [are] entitled * * * before the stockholders [can] retain it for any purpose whatever' "). Thus, the crucial statutory issue is whether the equity holders retain that property "on account of" their prior interest in the debtor.

The words "on account of" denote a causal relationship. See Random House Dictionary of the English Language 13 (2d ed. 1987) (on account of: "a. by reason of; because of. b. for the sake of"). The question is this case is whether the proposed plan, by allowing the prepetition equity holders to receive equity in the reorganized firm in exchange for cash payments, grants them property "on account of" their prepetition interests. Put differently, is being an equity holder a *cause* of receiving property under the proposed plan of reorganization? An examination of the reorganization procedures in Chapter 11 leaves no doubt that this is the case: absent the prepetition equity holders' interest in respondent, they would not have the

opportunity to receive any property under the proposed plan of reorganization.

First, only a debtor or a party in interest may file a plan of reorganization. See 11 U.S.C. § 1121. Outsiders are not allowed to file plans. The plan in this case was filed by the debtor, which is run for the benefit of the equity holders.[3] Absent the preexisting equity interest, the prepetition equity holders would have no basis on which they could even file a plan of reorganization. Moreover, no other party in interest would file a plan in this case which gave the prior equity holders the right to purchase the equity interest in the reorganized firm. Petitioner, the only secured claim holder and the major unsecured claim holder, has objected to this plan. There is no indication that the trade creditors would propose such a plan. Thus, only because the prepetition equity holders were equity holders were they permitted to file the plan gives them the option to purchase the equity interest in the firm. This is but one way in which the old equity holders are receiving the exclusive opportunity to purchase postpetition equity "on account of" their prepetition equity holdings.

Moreover, under Chapter 11, the debtor is given the exclusive right to file a proposed plan of reorganization for the first 120 days after the bankruptcy petition has been filed. This "exclusivity period" extends to 180 days if the debtor files a plan within the initial 120-day period. 11 U.S.C. § 1121(c). The bankruptcy court has the power to extend the exclusivity period beyond the 180-day limit. See 11 U.S.C. 1121(d). In many cases, courts

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[3] The debtor in this case is a limited partnership (Pet. App. 103a), and the limited partners are considered the debtor's equity holders under the Code. See 11 U.S.C. § 101 (16) & (17). A limited partnership is comprised of at least one general partner and limited partners, with the general partner owing fiduciary duties to the limited partners. See Harold Gill Reuschlein & William A. Gregory, The Law of Agency 444 (2d ed. 1989). Given these legal duties, it is fair to conclude that the debtor in proposing the plan is acting on behalf of its equity holders.

grant such extensions. See Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 Wisc. L. Rev. 729, 753 (reporting that in 79% of cases studied, exclusivity continued throughout the case). This is a case in point. The original and amended plans were filed within the exclusivity period. See Pet. App. 103a-04a. Petitioner moved to terminate the exclusivity period, so that it could file a competing plan. The Bankruptcy Court denied the motion and continued to extend the exclusivity period. See J.A. 16-17. Thus, as is quite common under prevailing practice, the debtor is the only party that ever has had an opportunity to file a plan of reorganization. By statutory prescription, the prepetition equity holders have the right to propose this plan of reorganization only because they are the prepetition equity holders.[4]

The ability to propose a plan of reorganization provides a significant advantage in the reorganization process. The Code specifies the minimum content of a plan of reorganization, and accords substantial discretion in the content of the plan to its proponent. Thus, the right to propose a plan of reorganization, whether exclusive or not, shapes the reorganization process. The right to make an offer, especially if it can be the only offer on the table, allows the party with that right to affect the terms of settlement. See Douglas G. Baird, Robert H. Gertner & Randal C. Picker, Game Theory and the Law 60 (1994) ("a game's

[4] Respondent in its Response in Opposition notes that petitioner moved to terminate respondent's exclusivity period, that the bankruptcy court denied this motion, and that petitioner did not appeal this denial. Opp. 16. Respondent asserts that this failure to appeal "waived" any argument based on exclusivity. *Id.* Respondent misses the point. Even if exclusivity were terminated, it would still be the case that the equity holders have the right to propose this plan because they are equity holders. To be sure, the value of that right varies depending on whether it is exclusive or not, but the question before the Court is not one of valuation, it is one of cause. Here, respondent's right to propose the plan, which happens to be exclusive, is a cause of their retaining property under the plan.

likely course of play is often determined by which party moves first"); LoPucki, *supra* at 753-54 (debtors use exclusivity to extract concessions from creditors).[5] Only if one were to ignore the origin of the new value plan at issue here could one even contemplate the notion that equity holders are not receiving the equity in the reorganized firm "on account of" their prepetition equity holdings.

Finally, and perhaps most importantly, under the plan in this case, only the debtor's prepetition equity holders were granted the option to purchase equity in the reorganized firm. Pet. App. 57a-58a. No other parties were offered the opportunity to either purchase equity on the same terms as the old owners, or even to bid against the old owners for the equity interest, offering *better* terms than the old equity holders. The old equity holders were granted the exclusive right to purchase postpetition equity. In short, one had to be a prepetition equity holder in order to receive the *right* to purchase equity under this plan of reorganization. Stated differently, the right of respondent's partners to acquire all of the equity under the plan is exclusive of the rights of all third parties to bid on or otherwise acquire that interest, *even if they would pay more than respondents' partners.*

[5] The value of this right stems from the fact that even unbiased courts can err, and anyone who proposes a plan or reorganization is aware of this fact. Consequently, if a prepetition equity owner offers a new cash contribution, that owner has an incentive to ask for too much in return. If the court recognizes that the proposed plan would overcompensate the equity owner, the court will refuse to confirm the plan over creditor objection, and the equity owner will gain nothing from its offer. But nothing is lost. If, in the alternative, the court errs and finds that the plan would properly compensate the equity owner for her contribution, then the equity owner would benefit. As a result, anyone who has a right to request cramdown can expect to gain from that right. While prepetition equity holders undoubtedly have a right under the Code to propose such a plan, it is this right which spawned the plan at issue in this case.

The exclusive nature of the preptition equity holders' right under the plan to purchase new equity violates the express terms of the Bankruptcy Code. The plan defines the class of those who can purchase new equity in terms of whether or not they were previous equity holders. They thus are receiving the exclusive right to acquire property—itself "property"—"on account of" their prepetition equity interests, in violation of Section 1129(b)(2)(B).

By themselves and together, these facts show that the plan of reorganization in this case allowed prepetition equity holders to retain the equity interest in the firm "on account of" their equity in the debtor. This the Bankruptcy Code expressly prohibits.

B. The Court of Appeals' Reading of Section 1129 (b)(2)(B) Is Erroneous

The Court of Appeals attempted to evade the plain language of the Code through a form of confession and avoidance. It acknowledged that having the status of a prepetition equity holder was a necessary condition to retaining the equity interest in the debtor. But the court also noted that having a prebankruptcy equity interest was not a sufficient condition for retaining that interest. It stated that the old equity holders' retention of their interest depends on their making a "new, substantial, necessary and fair infusion of capital." Pet. App. 17a.[6] According to the Court of Appeals, it is "on account of" the infusion of funds, *rather than* their status as prepetition

[6] While the Court of Appeals stated that the contribution of capital was "necessary" for a successful reorganization, it is hard to see how this is the case. The debtor is a partnership whose sole asset is 15 floors of an office building. Pet. App. 103a. There is no dispute as to the deployment of the debtor's assets in this case; the only issue is who retains the equity interest. Given this, it is hard to see how there is any "necessity" here for the equity holders' contribution. Such contribution may be necessary for their continued participation, but it is not necessary for a successful reorganization.

equiy holders, that renders the plan in compliance with the Code.

There are two flaws with this argument. First, the exclusive right to purchase postpetition equity is itself property. See *In re Coltex Loop Central Three Partners, L.P.*, 138 F.3d 39, 43 (2d Cir. 1998); *In re Bryson Properties*, 961 F.2d 496, 504 (4th Cir. 1992); *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990). The only ones who receive this right are the prepetition equity holders, and the only plausible basis on which they are receiving this right is their status as prepetition equity holders. Indeed, in this case, it is because the prepetition equity holders face substantial tax liability based on their equity holdings that they have proposed a plan which grants them the opportunity to purchase postpetition equity. Opp. 19.

Even if one were to focus solely on the purchase of postpetition equity rather than the right to make such a purchase, the Court of Appeals' argument fails. The court's conclusion rests on a non sequitur. To be sure, one of the conditions for the prepetition equity holders' ability to acquire the new equity under the plan is their monetary contribution to the reorganization. Nonetheless, this does not negate a second condition to their ownership of the reorganized firm: they also had to be prepetition equity holders. To repeat: were they not equity holders, they would not have the right to make such a monetary contribution in exchange for an equity interest.[7]

[7] There are a variety of academic proposals as to how to reform the Chapter 11 process. What is interesting to note about these proposals is that although some of them allow for current owners to bid for the firm, none of them gives the owners the exclusive right to do so. All require that such bids be subject to competing bids. See Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 114-15 (1991) (endorsing policy of new value plans contingent on amending the Code to allow competing bids); Philippe Aghion, Oliver Hart & John Moore, *The Economics of Bankruptcy Reform*, 3 J. L.

There are many reasons why the prepetition equity holders are allowed to retain the equity interest in this plan of reorganization. Some of these reasons relate to their being prepetition equity holders of respondent, one of them does not. It is quite uncontroversial to say that they retain their interest under the plan "on account of" their old equity *and* their new infusion of capital. Both are necessary conditions. The basic mistake of the Court of Appeals was to treat an instance of concurrent causation as if it were a case of superseding causation. This is a case of concurrent causation because both the equity holders' status as equity holders, and their infusion of new value, were necessary for approval of the plan. It does not follow from this that the infusion of new value somehow becomes the *only* cause of the equity holders' retention of property under this plan. Recognizing the various bases of the equity holders' participation in the proposed plan precludes confirmation of the plan over the objection of an impaired class of unsecured creditors. In short, the Court of Appeals read Section 1129(b) to forbid equity holder participation "*solely* on account of" prebankruptcy equity interests.[8] But the Code does not say "solely on account of"—it says "on account of." Given the undis-

Econ. & Org. 523, 533-36 (1992) (auction firm off to competing bids, which may include bids by management). Some have suggested caution in deciding to allow managers, who often are equity holders, from participating in the auction. See Robert G. Hansen & Randall S. Thomas, *Auctions in Bankruptcy: Theoretical Analysis and Practical Guidance*, 18 Int'l Rev. L. & Econ. 159, 178-78 (1998). No scholarly commentator of which we are aware has argued that, as a normative matter, it would be desirable to limit the bidding for postpetition equity to prepetition equity holders.

[8] The Court of Appeals in *Bonner Mall* bolstered its reading of the statute by arguing that if Congress sought to reject new value plans, it would simply have deleted the words "on account of such junior claim or interest." See In re Bonner Mall Partnership, 2 F.3d 899, 909 (9th Cir. 1993). From this, the court reasoned that the "on account of" language is designed to allow new value plans because they are "on account of" something else. One problem with this argument is that the language at issue can readily have a meaning which does not relate to new value plans. For example, it commonly happens that an equity holder has both a claim based on funds lent and an equity interest in the firm. Thus, the "on account of" language ensures that an equity holder who also holds a debt claim can participate in the reorganization "on account of" its debt claim, but not "on account of" its equity interest.

puted fact that being a prepetition equity holder is a necessary condition to retaining equity in the new firm, the proposed plan of reorganization violates the plain language of the Bankruptcy Code.

C. Congress's Action in Enacting the Bankruptcy Code Implies That There Is No New Value Exception to the Absolute Priority Rule

This plain language reading of the statute is bolstered by the congressional treatment of an analogous issue—whether a bankruptcy court can approve a plan under which senior claim holders give up some of the value of their claim to lower classes while not paying dissenting intermediate classes in full. For example, assume that a debtor that files for Chapter 11 has assets worth $150, the senior, secured creditor is owed $120, with collateral worth $120, and the junior creditors are owed $100. The question at issue is whether the bankruptcy court could approve, over the dissent of the junior creditors, a plan of reorganization which gave $100 to the senior creditor, $30 to the junior creditors, and $20 to the equity holders. The senior creditor might want to give up this value because it believes that the continued participation of the old equity holders is necessary for a successful reorganization.

Were the Court of Appeals' understanding of Section 1129(b)(2)(B) correct, such a plan would be confirmable. The hypothetical plan, like the plan in this case, grants property to junior creditors for two concurrent reasons, only one of which is their status as equity holders.

Under the rationale of the opinion below, the argument would be straightforward: the equity holders would receive equity "on account of" the senior creditor's decision to transfer part of the value of its claim in exchange for their continued participation in the enterprise—rather than "on account of" their prepetition equity interest. This reading of the "on account of" language, like that of the Court of Appeals in this case, vests the provision with the meaning "solely on account of", and thus permits reorganizations in which equity holder status is a necessary, but not the sole, reason for the acquisition of the equity in the reorganized firm.[9]

Congress, however, has expressly forbidden this result in the hypothetical case discussed above.[10] The bill passed by the Senate contained language that would have allowed court approval of such plans in which a senior creditor transfers value to junior interests over the dissent of intermediate creditors. See S. 2266, 95th Cong., 2d Sess., § 1130(a)(9)(A) (allowing court approval so long as dissenting class receives "*value* no less than under a plan that is fair and equitable") (italics added); see also Senate Rep. No. 95-598, 95th Cong., 2d Sess. 127 (1978) ("Paragraph 9(a) would permit a senior creditor to adjust his participation for the benefit of stockholders. In such a case, junior creditors, who have not been satisfied in full, may not object if, absent the 'give-up', they are receiving all that a fair and equitable plan would give them."). The House version, in contrast, contained language that in relevant part is identical to that at issue in this case. See H.R. 8200, 95th Cong., 2d Sess. § 1129(b)(2)(B)(iv) (court can approve plan over dissent of unsecured creditors provided that "holders of claims or interests of any class or claims or interests, as the case may be, that is junior to such class *will not receive or retain under the plan on account of such junior claims or interests any property*") (italics added). The House Committee Report made clear that this language did not allow senior creditors to cede their value to lower classes without paying intermediate creditors in full or obtaining their consent. See House Rep. No. 95-595, 95th Cong., 1st Sess. 416 (1977) (The language in Section 1129 "is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate junior class consents, is paid in full, or is unimpaired."). The bill as ultimately passed by Congress contained the language of the House bill. The floor statements that were made in lieu of a conference report note expressly that "the House report remains an accurate description of confirmation of section 1129(b). Contrary to the example in the Senate report, a senior class will not be able to give up value to a junior class over the dissent of an intervening class unless the intervening class receives the full amount, as opposed to value, of its claims or interests." 124 Cong. Rec. 32408 (Sept. 28, 1978). Congress thus expressly considered and rejected give up plans.[11]

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[9] It should be noted that if the Court of Appeals' reading were correct, it would call into question this Court's decision in *Ahlers*. The Ninth Circuit in *Bonner Mall* admitted as much. See 2 F.3d at 916 ("There is nothing in the text of the Code that prevents stockholders from obtaining property in the reorganized debtor in exchange for contributions of labor; such a transaction would not give old equity any property 'on account of' its prior ownership interests.").

[10] This rejection applies regardless of who proposes the plan.

[11] One can question the wisdom of this rejection. See Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. Chi. L. Rev. 738, 760-75 (1988). While Professors Baird and Jackson suggest that Congress should have allowed give up plans, they argue that where there is no such intermediate class, as in this case, courts should not second guess the decisions of the affected parties. See *id.* at 747-60. Indeed, while this Court never held that there was a new value exception to the absolute priority rule, see below, it did endorse give up plans. See *Kansas City Terminal Railway Co. v. Central Union Trust Co.*, 271 U.S. 445 (1926).

The import of this congressional rejection of give up plans is that new value plans must fail as well. Were a give up plan to come before a court, the same reading of the Code on which the Court of Appeals relied in this case would justify confirmation of such a plan over creditor objection. The proponent of such a plan would argue that the participation of the prepetition equity holders would be "on account of" the decision of the senior creditors to give up some of their claim because they had concluded that such participation was necessary to the successful reorganization of the firm. Structurally, the argument is identical to that pressed by the Court of Appeals here. New equity is given to prepetition equity holders *if* something else also happens—in new value plans, the equity holders choose to make cash contributions; in give up plans, senior claimants choose to transfer value to equity holders. The Court of Appeals' approach looks solely to the *contingent* fact—a choice made by one of the parties—while ignoring the background, *non-contingent* requirement in both situations—that the right to purchase postpetition equity is limited to prepetition equity holders. When Congress rejected this reasoning in the case of give up plans; it also implicitly rejected the same argument based on identical language as applied to new value plans. This Court should not resolve this case in a way that would lead to application of the statute in a way so plainly inconsistent with Congress's considered treatment of an analytically indistinguishable situation.

II. PRIOR PRACTICE UNDER THE BANKRUPTCY ACT COMPORTS WITH THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE

In addition to their statutory argument, the proponents of the new value theory advance a dubious historical argument. They assert that the practice prior to the adoption of the Code allowed for the approval of new value plans. See Pet. App. 20a; *Bonner Mall*, 2 F.3d at 912-13; *In re Synder*, 967 F.2d 1126, 1129 (7th Cir. 1992). They then invoke the "canon" of statutory construction that, in bankruptcy cases, "th[e] Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992).

In light of the clarity of Section 1129(b)(2)(B), this canon has no application to this case. As explained above, Congress did not authorize new value plans when it drafted Chapter 11. Moreover, even if the language of Section 1129 and the overall structure of Chapter 11 were ambiguous on this point, a holding from this Court that there is no new value exception would not be a major change from pre-Code practice. If anything, creating such an exception under the current voting scheme in Chapter 11 would be a significant departure from prior practice; it would allow approval of plans that could not have been approved under prior law.[12]

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[12] Before examining the state of the law prior to the passage of the Code, we first pause to question this "deference to past practice" approach to interpreting the Bankruptcy Code. In enacting the Code, Congress did not amend the Bankruptcy Act; it replaced it in its entirety. In Chapter 11, for example, Congress wrote a single provision for business reorganizations whereas prior law had three such provisions: Chapter X, Chapter XI and Chapter XII. These three provisions had differing standards for confirming plans of reorganization, and it was a major policy decision to switch to a universal Chapter 11. See J. Ronald Trost, et al., The New Federal Bankruptcy Code 239-40 (ALI 1979). While pre-Code practice may explain choices that Congress made, it is hard to see why there should be a presumption in favor of the law which Congress found inadequate.

The Court first articulated the "deference to past bankruptcy practice" rule in *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494 (1986). There the Court stated: "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation

The putative new value exception to the absolute priority rule stems from *dicta* in this Court's decision in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 121-22 (1939). In that case the Court, speaking through Justice Douglas, stated that equity holders could participate in a reorganized firm where "the necessity * * * of seeking new money [was] essential to the success of the undertaking". Id. at 121. This statement was dicta, for the Court ultimately held that the proposed contribution at issue was not sufficient. Id. at 122-23. This Court never ruled on the existence of a new value exception. See *Kham & Nate's Shoes No. 2*, 908 F.2d at 1360.[13] More-

of a judicially created concept, it makes that intent specific. *Edmonds v. Compagnie Generale Transatlantique*, 443 U.S. 256, 266-67 (1979). This Court has followed this rule with particular care in construing the scope of bankruptcy codifications." Even if this were the case with prior legislation in the bankruptcy area, it is hard to see why it should be so with current law.

If anything, one would imagine that the process which generated the Bankruptcy Code would lead to the conclusion that less deference should be accorded to past practice than is the case in other instances of statutory amendment. Congress focused on the need to revisit this country's bankruptcy laws in 1968, when it created a commission to study the need for major reform. The bankruptcy commission issued its final report in 1973. A group of bankruptcy judges, infuriated by their exclusion from the Commission, created their own bill. In 1974 both bills were introduced in Congress, and lengthy hearings were held in 1975 and 1976. These hearings led to new bills being introduced in the House and Senate, and a new round of hearings. The new Bankruptcy Code was eventually passed in 1978. See Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 Mich. L. Rev. 47, 67-74 (1997). Given this careful and extensive consideration of the Bankruptcy Code, and given the comprehensive overhaul that the Code provided, it is counterintuitive to venerate past practice. The Bankruptcy Act was out of date, and Congress undertook the review process because it wanted to remedy this defect. Congress clearly was reforming bankruptcy law here, not enshrining it.

[13] The sugestion by the court in *Bonner Mall* that the Supreme Court held that the new value exception exists in *Mason v. Paradise*

over, there are no reported lower court cases applying this exception prior to the passage of the Bankruptcy Code. See John D. Ayer, *Rethinking Absolute Priority after Ahlers*, 87 Mich. L. Rev. 963, 1016 (1989). There was no well-established new value exception to the absolute priority rule based on pre-Code practice.[14]

Any basis for even this tenuous historical claim has been removed by the fundamental change in reorganization law under the Code of 1978. To understand the nature of this change, it is helpful to examine the treatment of business bankruptcies under the prior Bankruptcy Act. The Act had three different chapters for business reorganizations—Chapters X, XI, and XII. In general, Chapter X was designed for publicly held firms, Chapter XI for privately held firms, and Chapter XII for real

Irrigation Dist., 326 U.S. 536, 541-42 (1946), misreads that opinion. The debtor in *Mason* had issued bonds which it could not pay. The Reconstruction Finance Corporation ("RFC") proposed to refinance the bonds at 52.521 cents on the dollar. *Id.* at 539. The holders of 92 percent of the bonds agreed to this refinancing, and sold their bonds to the RFC. *Id.* The debtor filed a petition under Chapter IX to force the remaining 8 percent of the bondholders to agree to this refinancing. *Id.* The plan of reorganization in *Mason* gave cash at 52.521 cents on the dollar to the bondholders who had not sold to the RFC, and gave new bonds, at 52.521 cents on the dollar to the RFC. *Id.* at 539-40. The new bonds carried a 4 per cent interest rate. *Id.* at 540. The Court held that this difference in treatment was allowable because the RFC, through its purchase of the outstanding bonds, had refinanced the debtor's operations. (In effect, it converted $476,000 of bonds at 6 per cent to $252,500 at 4 per cent). *Id.* at 541-42. Moreover, the Court noted that there was no showing that the bonds received by the RFC were more valuable than the cash given to the other bondholders. *Id.* at 543. *Mason* thus is a case about permissible differences in treatment of creditors holding the same claim; it does not involve absolute priority.

[14] This lack of historical implementation of the new value exception to the absolute priority undermines the court of appeals' statement that "[t]he new value corollary has been a major source of new funding in reorganizations for the past fifty years." Pet. App. 21a.

estate firms. After 1952, only Chapter X required that a reorganization plan be "fair and equitable." [15]

Case was decided under the predecessor to Chapter X—Section 77B—which required that a plan of reorganization be "fair and equitable." This test had to be met even if all classes of creditors approved the plan. See 308 U.S. at 114. In other words, the absolute priority rule could be invoked by an individual creditor to challenge a plan as not "fair and equitable" even if the class of which it was a member had consented to the plan of reorganization. Approval of a new value plan under the *Case* dicta required *both* class approval *and* a finding by the bankruptcy court that the stockholders were making a necessary contribution of capital to the new firm. This requirement of class consent means that the plan in this case could not have been confirmed under the Act. The new Code made confirmatiton easier in that class approval binds dissenting class members; *individual* creditors are no longer able to invoke the absolute priority rule. Thus, whereas the plan in this case would not have been approved under the Act, the plan in *Case* would have been approved under the Code.

We emphasize the extent to which the Court of Appeals' holding—that there is a new value exception to the absolute priority rule—deviates from prior law. Under

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[15] Chapters XI and XII, as originally enacted, also required plans to be "fair and equitable." After the Supreme Court made clear that "fair and equitable" required adherence to absolute priority, Congress deleted this requirement from Chapters XI and XII, but left it in Chapter X. See Act of July 7, 1952, ch. 579 §§ 35, 43 & 50; see also H.R. Rep. No. 2320, 82d Cong., 2d Sess. (1952), *reprinted in* 1952 U.S.C.C.A.N. 1960, 1981-82 (explaining that change was in reaction to *Boyd* and *Case*). That the absolute priority rule only applied in Chapter X explains the dearth of reported cases on the new value exception under the Act. Not only were there few cases under Chapter X, but also these are the type of firms—publicly held companies—most likely to attract outside financing.

pre-Code practice, shareholders who wanted to retain an equity interest in the reorganized firm both had to secure consent of all classes of creditors *and* make a contribution which satisfied the new value test. Congress in the Code made it clear that consent of creditor classes would be sufficient to approve a plan of reorganization in which the prepetition equity holders received an interest, regardless of whether the equity holders were making any new contribution. Under the Code, if all the creditor classes agree that the value of equity holders' continuation in the firm exceeds what they are to receive under the plan of reorganization, this agreement binds all creditors. The Court of Appeals held that, in the absence of creditor consent, equity holders could retain an interest so long as they made a new contribution. Algebraically, the Act required A + B for confirmation; Congress then enacted the Code, which requires only A for confirmation; the Court of Appeals held that a plan can be confirmed based on B alone. Whatever the merits of the Court of Appeals holding, it is not consistent with past practice.

III. SOUND BANKRUPTCY POLICY SUPPORTS THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE

Policy arguments support the reading of the Code set forth above. To see why this is so, consider the structure of the Chapter 11 reorganization process. Chapter 11 provides a forum in which the decision is made whether to liquidate [16] or reorganize the debtor, and, if the debtor is to be reorganized, how the debtor's assets should be deployed and what capital structure the reorganized firm should have. A Chapter 11 reorganization is premised on

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[16] Liquidation can occur either through a transfer to Chapter 7, or the approval of a liquidating plan of reorganization. In one study, liquidating plans of reorganization comprised about one quarter of all confirmed Chapter 11 plans. See Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97 Com. L.J. 297, 318-19 (1992).

bargaining among the affected parties. See House Report, *supra*, at 224 ("[N]egotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders."). Crucial to this negotiation is the plan of reorganization; it is the plan that sets forth the future of the firm. The Code allows the plan proponent to classify claims into classes. See 11 U.S.C. § 1123(a)(1). Holders of claims have two distinct sets of rights: those that they possess individually, and those that they possess as a member of the class in which they are included. Individually, each claim holder is entitled to receive no less than it would have received in a Chapter 7 liquidation of the firm. 11 U.S.C. § 1129(a)(7). As a member of a class, each holder has a vote. For a class to approve a plan, over half of the holders, whose claims total more than two-thirds of the amount of claims in the class, have to vote in favor of the plan. 11 U.S.C. § 1126. To the extent that a class objects, the rights of the class turn on whether the claim is secured or unsecured. If it is secured, the plan can be confirmed only if the dissenting class is to receive the full present value of its claim under the plan. See 11 U.S.C. § 1129(b)(2)(A). If the dissenting class is unsecured, the plan can be confirmed only if the class is paid in full or if no junior claims or interests "receive or retain * * * on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B).

The logic behind this scheme is sound. It vests the party with the largest incentive to maximize firm value with the decision as to the firm's future. To the extent that the firm is worth less than the sum of its parts, any individual creditor can scuttle the reorganization effort by insisting on its right to be paid what it would have received in a Chapter 7 liquidation. Assuming that the firm is worth more kept together than it would be if liquidated, the exact division of the firm is left to negotiation among the parties. It is important to note that in these negotiations much is unceratin. The value of the reorganized firm is often subject to dispute. Moreover, the value of the contributions made by prepetition equity holders, both monetarily and in managing the firm, is also often unclear. The Chapter 11 rules set the terms of the negotiation. Absent any putative new value exception, these rules let the parties whose money is at stake select what they view as both the future value of the firm and the value of the continued participation by the equity holders. The prepetition equity holders are entitled to make the opening offer. They can overcome the dissent of the secured creditors by paying them the full amount of their claims. Since the claims of the secured creditors are defined by the value of their collateral, 11 U.S.C. 506(a), there always should be sufficient value to pay them off in full.

When a debtor is insolvent, the unsecured claims cannot be paid in full. The creditors who are not to be paid in full, however, have the appropriate incentives to make the choice which maximizes the value of the firm. If the prepetition equity holders propose to make contributions to the firm in excess of the value which they are receiving, the unsecured creditors can vote for the plan. If they believe either that the prepetition equity holders participation is not necessary for an effective plan of reorganization, or that the prepetition equity holders propose to take too much in exchange for their contribution, they can vote against the plan. Thus, to the extent that the equity holders can convince the marginal claimants that the holders are necessary to the reorganization effort, they can participate in the reorganized firm under any plausible reading of the Code.

The new value exception found by the Court of Appeals in this case distorts this negotiation. It asks the bankruptcy court to second guess the decision made by the unsecured creditors. It asks the court to determine whether the contribtuion made by the prepetition equity holders is necessary to an effective reorganization, and whether

the interest retained under the plan is reasonably equivalent to the interest contributed. Creditors can no longer make proposals and vote based on their view of the correct division of the firm. Rather, they have to take account of the fact that, if they dissent from a plan because they are not being paid in full and they believe that the equity holders are receiving more under the plan than they are contributing, then the bankruptcy court may nevertheless approve such a plan over their objections.

There is no reason to substitute the judgment of the bankruptcy court for that of the creditors. Creditors that are not being paid in full have the strongest incentives to maximize firm value. If the firm turns out to be worth more, they stand to benefit. If the firm turns out to be worth less, they suffer the loss. It is hard to imagine why, over the broad range of cases, the bankruptcy court is in a better position to decide the value of the continued participation of the prepetition equity holders than are the parties whose money is at stake.

The major policy argument offered in favor of the new value exception is the argument that shareholders are a necessary source of new funding for reorganization efforts. See Pet. App. 21a; *Bonner Mall*, 2 F.3d at 915. This argument, not supported by statutory text, should be addressed to Congress. Moreover, it is unclear that this particular argument has any merit. First, if the old equity holders are in fact making a valuable contribution to the reorganization effort, the creditors that are not being paid in full more than likely would consent to the proposed plan. Second, the "necessity" argument is premised on the assumption that capital markets are not able to fund worthwhile reorganization efforts. However, a recent study of distressed debt discovered that, in most cases in which a loan becomes distressed, the owners of the firm are able to secure new funding or reach an accommodation with the lender. See Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 Mich. L. Rev. 159, 182-83, 192-94, 208-09 (1997). This appears

to have been the case at the time that the Code was enacted. See Walter J. Blum & Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. Chi. L. Rev. 651, 672 (1974) ("Current data do not support the belief that old shareholders are a fruitful source of additional funds when the public capital markets are unlikely to provide funds. In recent years shareholders have seldom contributed new capital."). Although some distressed debtors might have difficulty locating financing, that is not proof of a problem. The availability of funding for many distressed debtors suggests that the difficulty that some face might be entirely appropriate. Given the evidence suggesting a well-functioning market for financing these borrowers, the broad speculation of the Court of Appeals should not be credited.

The other policy argument which has been invoked in favor of the new value exception is that Congress attempted through Chapter 11 to encourage reorganizations, and since the new value plans at issue are "necessary" for an effective reorganization, they should be approved. See *Bonner Mall*, 2 F.3d at 916. The problem with this argument is not the premise, which is undoubtedly true: Congress *did* intend to promote reorganizations through Chapter 11,[17] and the removal of the right to invoke the absolute priority rule from individual creditors was a major advancement toward promoting reorganizations. The problem with the argument is its conclusion: simply because Congress wanted to promote reorganizations in general does not justify the inference that it sanctioned the new value exception to the absolute priority rule. Congress did not enact every pro-reorganization rule that one could imagine. Give-up plans, mentioned above, also may have had the effect of promoting reorganizations, but Con-

[17] While Chapter 11 has in fact promoted reorganizations, it has not promoted successful reorganizations. See Jensen-Conklin, *supra*, at 323-25 (6.5% of cases studied resulted in a confirmed and consummated plan); see also LoPucki & Whitford, *supra*, at 608 (52% of large, publicly held corporations filed a second Chapter 11 petition after having confirmed a plan of reorganization).

gress rejected them. Thus, the general preference toward reorganization is not enough to overcome the lack of textual and historical support for a new value exception.

The language, history and policies of the Bankruptcy Code lead to the same conclusion. Section 1129 prohibits confirmation of a plan, proposed by the prepetition equity holders, which grants them an exclusive right to purchase equity in the new firm over the dissent of a class of creditors which is not being paid in full.

CONCLUSION

The judgment of the Court of Appeals should be reversed.

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Supreme Court of the United States
OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION,
Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

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31pp

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	2
SUMMARY OF ARGUMENT	2
ARGUMENT	4
I. THE PLAIN LANGUAGE OF SECTION 1129(b)(2) OF THE BANKRUPTCY CODE PROHIBITS THE GRANT TO OLD EQUITY, OVER THE OBJECTION OF A CLASS OF CREDITORS, OF AN EXCLUSIVE RIGHT TO PURCHASE OWNERSHIP OF THE REORGANIZED DEBTOR	4
II. THE LAW AND PRACTICE PREVAILING BEFORE THE ENACTMENT OF THE BANKRUPTCY CODE IN 1978 DO NOT SUPPORT THE DECISION OF THE COURT OF APPEALS	9
A. Pre-Code Law and Practice Are Irrelevant When the Language of the Bankruptcy Code Is Clear	10
B. The New Value Doctrine Was Not an Established Element of Pre-Code Law or Practice	12
C. Congress Indicated Clearly That It Intended to Eliminate the New Value Doctrine When It Modified and Codified the Absolute Priority Rule, Without Exception, as Part of a Complete Overhaul of the Reorganization Provisions of the Bankruptcy Act	14
III. AN EQUITY-ONLY NEW VALUE RIGHT IS INCONSISTENT WITH THE POLICIES UNDERLYING THE BANKRUPTCY CODE	21
CONLUSION	25

TABLE OF AUTHORITIES

Cases — Page

In re Abbotts Dairies of Pennsylvania, Inc., 788 F.2d 143 (3d Cir. 1986) 22
Barnhill v. Johnson, 503 U.S. 393 (1992) 8
In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994) 3, 7
In re Bryson Properties, XVIII, 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992) 5
Caminetti v. United States, 242 U.S. 470 (1917) 8
Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) ..... *passim*
Central Trust Co. v. Official Creditors' Committee, 454 U.S. 354 (1982) 9
In re Coltex Loop Central Three Partners, L.P., 138 F.3d 39 (2d Cir. 1998) 5
Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510 (1941) 12
Dewsnup v. Timm, 502 U.S. 410 (1992) 9, 10, 13
In re Food Barn Stores, Inc., 107 F.3d 558 (8th Cir. 1997) 22
Kansas City Terminal Railway Co. v. Central Union Trust Co., 271 U.S. 445 (1926) 12, 15
Kelly v. Robinson, 479 U.S. 36 (1986) 11, 13
Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351 (7th Cir. 1990) 5, 21
M.R.R. Traders, Inc. v. Cave Atlantique, Inc., 788 F.2d 816 (1st Cir. 1986) 22
Marine Harbor Properties, Inc. v. Manufacturer's Trust Co., 317 U.S. 78 (1942) 12, 16
Mason v. Paradise Irrigation District, 326 U.S. 536 (1946) 12
Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 (1986) 10, 13
Nobelman v. American Savings Bank, 508 U.S. 324 (1993) 20
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 5
Patterson v. Shumate, 504 U.S. 753 (1992) 8, 21

TABLE OF AUTHORITIES—Continued

Page

Pennsylvania Department of Public Welfare v. Davenport, 495 U.S. 552 (1990) 9
In re Perimeter Park Investment Associates, Ltd., 697 F.2d 945 (11th Cir. 1983) 16
Protective Committee for Independent Stockholders v. Anderson, 390 U.S. 414 (1968) 16
Rake v. Wade, 508 U.S. 464 (1993) 8
In re Robert L. Helms Construction & Development Co., 139 F.3d 702 (9th Cir. 1998) 5
SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965) 16, 19, 20
SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940) 12, 16
In re Tobiason, 185 B.R. 59 (Bankr. D. Neb. 1995) 6
Toibb v. Radloff, 501 U.S. 157 (1991) 8, 21
Union Bank v. Wolas, 502 U.S. 151 (1991) 8, 15, 19
United Savings Association v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365 (1988) 14, 15, 18
United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989) 8, 10, 13, 14
United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) 21

Statutes

11 U.S.C. § 101 11
11 U.S.C. § 363 22
11 U.S.C. § 523(a)(7) 11
11 U.S.C. § 1104(a) 19
11 U.S.C. § 1107(a) 19
11 U.S.C. § 1121 20
11 U.S.C. § 1121(b) 3
11 U.S.C. § 1121(d) 3
11 U.S.C. § 1123(b)(5) 20
11 U.S.C. § 1126(c) 17, 24
11 U.S.C. § 1129(a) 8
11 U.S.C. § 1129(a)(7)(A) 17
11 U.S.C. § 1129(b) ..... *passim*
11 U.S.C. § 1129(b)(1) 4, 8, 17

TABLE OF AUTHORITIES—Continued

	Page
11 U.S.C. § 1129(b)(2)	*passim*
11 U.S.C. § 1129(b)(2)(B)	5, 17
11 U.S.C. § 1129(b)(2)(B)(ii)	5, 6
Act of June 7, 1934, ch. 424, 48 Stat. 911 (superseded 1938)	12
Act of June 22, 1938, ch. 575, 52 Stat. 840 (repealed 1979)	16
Act of July 7, 1952, Pub. L. No. 82-456, 66 Stat. 420 (repealed 1979)	16
Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 et seq.) (repealed 1979)	9
Bankruptcy Act § 156 (11 U.S.C. § 556) (repealed 1979)	19
Bankruptcy Act §§ 167-170 (11 U.S.C. §§ 567-570) (repealed 1979)	20
Bankruptcy Act §§ 172-175 (11 U.S.C. §§ 572-575) (repealed 1979)	23
Bankruptcy Act § 216 (11 U.S.C. § 616) (repealed 1979)	20
Bankruptcy Act § 221(2) (11 U.S.C. § 621(2)) (repealed 1979)	15
Bankruptcy Act § 306(1) (11 U.S.C. § 706(1)) (repealed 1979)	20
Bankruptcy Act § 323 (11 U.S.C. § 723) (repealed 1979)	20
Bankruptcy Act § 332 (11 U.S.C. § 732) (repealed 1979)	19
Bankruptcy Act § 342 (11 U.S.C. § 742) (repealed 1979)	19
Bankruptcy Act § 357 (11 U.S.C. § 757) (repealed 1979)	20
Bankruptcy Act § 366 (11 U.S.C. § 766) (repealed 1979)	16
Bankruptcy Act § 432 (11 U.S.C. § 832) (repealed 1979)	19
Bankruptcy Act § 444 (11 U.S.C. § 844) (repealed 1979)	19
Bankruptcy Act § 461 (11 U.S.C. § 861) (repealed 1979)	20

TABLE OF AUTHORITIES—Continued

	Page
Bankruptcy Act § 472 (11 U.S.C. § 872 (repealed 1979)	16
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Other Authorities	
American Council of Life Insurance, *Life Insurance Fact Book* (1997)	2
John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963 (1989)	13
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Collier on Bankruptcy (Lawrence P. King ed., 15th ed. rev. 1997)	13, 18
124 Cong. Rec. (daily ed. Sept. 28, 1978) (statement of Rep. Don Edwards)	18, 19
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Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69 (1991)	13
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Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775 (1987)	21

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

No. 97-1418

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

The American Council of Life Insurance ("ACLI") respectfully submits this brief *amicus curiae* in support of petitioner.[1] Petitioner (the "Bank") and respondent (the "Debtor") have consented to the filing of this brief, and their letters of consent have been filed with the Clerk of the Court.

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[1] In accordance with Supreme Court Rule 37.6, ACLI represents that no party other than counsel for ACLI authored this brief in whole or in part, and no person or entity, other than ACLI, has made a monetary contribution to the preparation or submission of this brief.

INTEREST OF *AMICUS CURIAE*

ACLI is the principal national trade association of life insurance companies. The 532 member companies of ACLI account for eighty-nine percent of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1996, life insurance companies' net investment in U.S. money and capital markets totaled $107 billion, more than ten percent of total institutional funds flowing into the financial markets. American Council of Life Insurance, *Life Insurance Fact Book* 50 (1997). At year-end 1996, life insurers held $951.7 billion in corporate bonds and $207.8 billion in mortgages. *Id.* at 53, 102.

The interest of ACLI as *amicus* arises out of the importance of this case to the commercial lending community. As a principal source of investment capital for both real estate developments and operating businesses, life insurance companies have a broad and important perspective on the proper resolution of the question presented in this case.

SUMMARY OF ARGUMENT

The question presented in this case is "[w]hether the Bankruptcy Code authorizes a judge to confirm a Chapter 11 plan of reorganization that grants the prebankruptcy equity owners of a debtor an exclusive opportunity to retain or purchase an ownership interest in the reorganized debtor, but does not provide for full payment to a senior, objecting class of unsecured creditors." Pet. for Cert. at i. For the sake of brevity and clarity, we refer to the pre-bankruptcy equity owners of the debtor as "old equity" and the exclusive opportunity to retain or purchase the ownership of the debtor as an "equity-only new value right."

The plan of reorganization filed by the Debtor while it had the exclusive right to file a plan [2] and confirmed by the bankruptcy court granted to old equity an equity-only new value right.[3] This right, which is equivalent to an exclusive option to purchase ownership of the reorganized partnership, constitutes property received by old equity on account of old equity's junior interest in the Debtor. Section 1129(b)(2) of the Bankruptcy Code plainly prohibits such a grant of property to old equity in the circumstances of this case.

The Court of Appeals relied on what it believed to be the law and practice before the enactment of the Bankruptcy Code in 1978 and concluded that Congress did not intend to change this practice when it enacted the Bankruptcy Code. The court's reasoning is erroneous in several respects. The clear language of the Bankruptcy Code precludes reliance on pre-Code practice, which, in any event, did not authorize an equity-only new value right. Even if the Court of Appeals had interpreted the historical record correctly, however, the court failed to recognize that Congress intended to alter pre-Code practice, as demonstrated by Congress' substantial reworking of pre-Code reorganization law and its careful treatment of the pre-Code absolute priority rule.

Policy considerations also support reversal of the judgment of the Court of Appeals. An equity-only new value

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[2] During the first 120 days after the commencement of a Chapter 11 case, the debtor has the exclusive opportunity to file a reorganization plan. 11 U.S.C. § 1121(b). The bankruptcy court may increase this exclusive period for cause. *Id.* § 1121(d).

[3] The plan in the case at bar was filed and confirmed during the Debtor's statutory exclusive period under Section 1121(b), as extended by the bankruptcy court. Accordingly, this case does not present the issue addressed by the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994), as to the permissibility of an equity-only new value right after the expiration of the debtor's exclusive period.

right does nothing to support the policy of the Bankruptcy Code favoring reorganization, and it is entirely inconsistent with the important policy of maximizing the value of the bankruptcy estate. The Court of Appeals' decision also inserts the bankruptcy judge inappropriately into the plan confirmation process and strips from creditors their power to determine what course of action is in their own best interests.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 1129(b)(2) OF THE BANKRUPTCY CODE PROHIBITS THE GRANT TO OLD EQUITY, OVER THE OBJECTION OF A CLASS OF CREDITORS, OF AN EXCLUSIVE RIGHT TO PURCHASE OWNERSHIP OF THE REORGANIZED DEBTOR.

The plain language of Section 1129(b)(2) of the Bankruptcy Code requires that the question presented in this case be resolved in favor of the Bank. When one or more classes of creditors rejects a proposed plan of reorganization in a Chapter 11 case, the bankruptcy court may confirm the plan only if the plan is, among other things, "fair and equitable" with respect to each objecting class. 11 U.S.C. § 1129(b)(1). Section 1129(b)(2) provides several specific requirements of the fair and equitable standard, including the Bankruptcy Code's absolute priority rule. With respect to a class of unsecured claims such as the Bank's deficiency claim in the instant case, a plan is not fair and equitable unless:

> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B). As this Court has recognized, "the absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.'" *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) (quoting Eighth Circuit opinion) (alteration by this Court).

It is undisputed that the Bank will not receive property under the plan of a value equal to the allowed amount of its unsecured deficiency claim. *See* Resp. to Pet. for Cert. at 3 (acknowledging that the Bank is projected to receive payments with a present value equivalent to 16% of its deficiency claim). The bankruptcy court's confirmation of the reorganization plan proposed by the Debtor, therefore, was proper only if holders of interests in the Debtor (*i.e.*, old equity) did not "receive or retain under the plan on account of such junior . . . interest[s] any property." 11 U.S.C. § 1129(b)(2)(B)(ii).

Although the Debtor suggests that old equity did not receive any "property" under the plan, *see* Resp. to Pet. for Cert. at 17-19, this Court has held that ownership of a reorganized debtor, even if it is apparently worthless, constitutes "property," *see Ahlers*, 485 U.S. at 207-08. Similarly, old equity's opportunity to purchase this property to the exclusion of competing offers from other parties also is "property." *See In re Coltex Loop Central Three Partners, L.P.*, 138 F.3d 39, 42-43 (2d Cir. 1998); *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992); *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990).[4] *See generally Ahlers*, 485 U.S. at 208

[4] *Cf. In re Robert L. Helms Constr. & Dev. Co.*, 139 F.3d 702, 706 (9th Cir. 1998) (en banc) (holding that option to purchase real property is not an executory contract; suggesting that it is

(recognizing that Congress intended meaning of "property" to be "quite broad").

The next interpretive question in this case is whether old equity received its property "on account of" its prepetition ownership interest in the Debtor. 11 U.S.C. § 1129(b)(2)(B)(ii). In any case involving an equity-only new value right, the old equity owners are chosen from the universe of possible investors as the only individuals who will receive a chance to invest in the reorganized debtor because they are the old equity owners. In this case, it is clear that this is precisely what happened. As the Debtor's papers and the bankruptcy court's decision demonstrate, the old equityholders received this opportunity specifically because they were faced with significant tax liabilities if a plan could not be confirmed and the Bank foreclosed its mortgage on the property. *See* Resp. to Pet. for Cert. at 1, 17; App. to Pet. for Cert. at 112a-113a. No one other than old equity faced such tax liabilities.

The members of the Court of Appeals panel disagreed about whether old equity received ownership of the reorganized Debtor "on account of" new capital contributions or "on account of" former equity interests. *See* App. to Pet. for Cert. at 21a, 35a. What is at issue in this case, however, is not why old equity obtained ownership of the reorganized Debtor, but why the plan granted old equity an *exclusive* opportunity to contribute new capital in exchange for ownership.[5] Any suggestion that old equity

property of bankruptcy estate); *In re Tobiason*, 185 B.R. 59, 63 (Bankr. D. Neb. 1995) (holding that option to purchase stock of another company is property of debtor's bankruptcy estate).

[5] A red herring frequently colors the arguments of debtors and courts in favor of an equity-only new value right. It is the erroneous conclusion that absent an equity-only new value right, old equity would be barred from owning an interest in the reorganized debtor unless either (1) all classes of creditors accepted the plan or (2) all creditors were to be paid in full. The Ninth Circuit, for example, reasoned that if an equity-only new value right were impermissible, "[w]e would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor [where senior classes are not paid in full]." *Bonner Mall*, 2 F.3d at 909. The law does not require, and ACLI does not suggest, that old equity may never own or control the reorganized debtor unless all classes of creditors either consent to the plan or are paid in full. The absolute priority rule does prohibit a plan that gives old equity exclusive rights to purchase interests in the reorganized debtor while other parties are precluded from having an opportunity to bid for and purchase interests in the reorganized debtor. A new value right that is limited to old equity only, as the Debtor's was, is a grant of property to old equity on account of old equity's ownership of the debtor and triggers the prohibition of Section 1129(b)(2).

received an *exclusive* opportunity to contribute new capital solely "on account of" its contribution of new capital would, of course, be nonsensical.[6] Instead, both the record and common sense indicate that the Debtor selected the old equityholders to receive this benefit precisely because they were the old equityholders.

[6] In attempting to answer this question—*i.e.*, "on account of" what does old equity receive an exclusive opportunity to purchase ownership of the reorganized debtor?—the Court of Appeals resorted to a bald policy proposition:

> As a practical matter, the opportunity to participate in a reorganization plan, even an exclusive right, is not retained on account of an old equity holder's former ownership interest; the opportunity to give new value and to have the opportunity to receive a return on that capital infusion is given because such participation, even exclusive participation, may enhance the value of the business after reorganization.

App. to Pet. for Cert. at 21a. This proposition is dubious as a matter of policy, for it is not at all clear that the value of a business is enhanced when willing investors are not permitted to offer to purchase ownership. It also is unpersuasive as a matter of statutory interpretation, for it simply fails to explain why the equity-only new value right that the old equityholders received to enable them to defer their tax liabilities was not given to them "on acount of" their equity interests.

The Bankruptcy Code provides no exception to the absolute priority rule in the circumstances of this case.[7] Nor is there any ambiguity about the meaning of the absolute priority rule on the facts presented here.[8] In short, there is no statutory justification for the decision of the Court of Appeals in this case.

Where a "statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). "[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute." *Id.* at 240-41. *See also Rake v. Wade*, 508 U.S. 464, 471-73 (1993) (quoting and following *Ron Pair*); *Patterson v. Shumate*, 504 U.S. 753, 759-61 (1992) (holding that clear statutory language precluded reliance on legislative history); *Barnhill v. Johnson*, 503 U.S. 393, 401 (1992) (noting that reference to statutory history is appropriate only to resolve statutory ambiguity); *Union Bank v. Wolas*, 502 U.S. 151, 156-62 (1991) (holding that plain language of Bankruptcy Code controlled, despite arguments that legislative history, pre-Code practice, and policy considerations supported different result); *Toibb v. Radloff*, 501 U.S. 157, 162 (1991)

[7] The absolute priority rule does not apply if all classes of creditors accept the plan, nor does it apply in a cramdown situation to a class that has accepted a plan. *See* 11 U.S.C. §§ 1129(a), 1129(b)(1). Because the class of unsecured creditors that included the Bank rejected the plan, the absolute priority rule applies here.

[8] The Court of Appeals concluded that Section 1129(b) is ambiguous because courts and scholars have disagreed about its proper interpretation. *See* App. to Pet. for Cert. at 18a-19a. This Court, however, regularly interprets the Bankruptcy Code, among other statutes, according to its plain meaning despite recognizing that other courts and commentators have disagreed. *See, e.g., Toibb v. Radloff*, 501 U.S. 157, 160-62 & n.3 (1991); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 238 & n.1, 241 (1989).

(holding that where language of Bankruptcy Code is clear, reference to legislative history is unnecessary); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563-64 (1990) (holding that pre-Code practice did not override clear language of Bankruptcy Code); *Central Trust Co. v. Official Creditors' Committee*, 454 U.S. 354, 359-60 (1982) (per curiam) (holding that court's belief about best interests of bankruptcy estate cannot override unambiguous statutory language).

Accordingly, because the plain meaning of Section 1129 of the Bankruptcy Code prohibits an equity-only new value right, the Court of Appeals erred in affirming confirmation of the Debtor's plan of reorganization.

II. THE LAW AND PRACTICE PREVAILING BEFORE THE ENACTMENT OF THE BANKRUPTCY CODE IN 1978 DO NOT SUPPORT THE DECISION OF THE COURT OF APPEALS.

The Court of Appeals reasoned that the so-called "new value corollary" had a longstanding heritage under the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 et seq.) (repealed 1979) (hereinafter the "Bankruptcy Act"). Drawing on this Court's direction that the Bankruptcy Code should not be interpreted to alter practice under the Bankruptcy Act without an indication that Congress intended such a change, the Court of Appeals concluded that the "new value corollary" survived the enactment of the Bankruptcy Code in 1978 and allowed the equity-only new value right in this case. *See* App. to Pet. for Cert. at 21a-23a.

This Court has recognized that Congress did not write on a clean slate when it enacted the Bankruptcy Code in 1978. *See Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). The courts "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 485 U.S. at 563. In general, this Court assumes that "if Con-

gress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494, 501 (1986). Further, the Court is "reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup*, 502 U.S. at 419.

The Court of Appeals erred in three respects in its application of these principles to the instant case. First, when the language of the Bankruptcy Code is clear, resort to pre-Code practice is inappropriate. Second, the "new value corollary" was not an established element of bankruptcy law before 1978. Third, Congress gave a clear indication that it intended to depart from the pre-Code absolute priority rule when it enacted the Bankruptcy Code in 1978.

A. Pre-Code Law and Practice Are Irrelevant When the Language of the Bankruptcy Code Is Clear.

As discussed above in Part I, there is no ambiguity in Section 1129(b) of the Bankruptcy Code as applied to the facts of this case. Where the language of the Bankruptcy Code is not "at least to some degree . . . open to interpretation," pre-Code practice cannot override the language of the Bankruptcy Code. *Ron Pair*, 489 U.S. at 245; *see also Davenport*, 485 U.S. at 552-53 (applying clear language of Bankruptcy Code despite contrary pre-Code practice). Similarly, an absence of discussion in the legislative history cannot alter the Bankruptcy Code's plain meaning. *See Dewsnup*, 502 U.S. at 419-20 ("Of course, where the language is unambiguous, silence in the legislative history cannot be controlling."). As the Court has recognized in these and the other cases cited in Part I, the plain language of the Bankrupcy Code is the clearest guide to congressional intent, and other considerations do not override Congress's choice of clear statutory wording.

Two of this Court's cases are instructive in this regard. In *Kelly v. Robinson*, 479 U.S. 36 (1986), the Court considered whether a criminal restitution order is dischargeable in a case under Chapter 7 of the Bankruptcy Code. The Court recognized that pre-Code practice included a judicially-created exception to discharge for restitution orders. *See id.* at 45-46. The Court determined that the ambiguous language in the relevant discharge provision, 11 U.S.C. § 523(a)(7), did not reveal an intent to alter the pre-Code rule and concluded that restitution orders remain nondischargeable. *See id.* at 47-53.

Three Terms later, in *Davenport*, the Court again considered the dischargeability of a restitution order, this time in a Chapter 13 case. Because Section 523(a)(7) does not apply in Chapter 13 cases, the Court looked to the definitions of "debt" and "claim" in 11 U.S.C. § 101. Concluding that a criminal restitution obligation is a debt within the meaning of that section of the Bankruptcy Code and recognizing that Chapter 13 provides for a broad discharge of debts, the Court held that a restitution obligation is dischargeable in a Chapter 13 case. *See Davenport*, 495 U.S. at 557-63. The Court acknowledged that the Bankruptcy Code should not be read to alter past practice absent a clear congressional indication but found that "the statutory language plainly reveals Congress' intent not to except restitution orders from discharge in certain Chapter 13 proceedings." *Id.* at 563.

As in *Davenport*, the congressional intent behind the codification of the absolute priority rule is clear in this case. Section 1129(b) defines the contours of the rule without ambiguity and permits no exception for an equity-only new value right. In such a case, the Court's "sole function is to enforce the statute according to its terms." *Id.* at 564.

B. The New Value Doctrine Was Not an Established Element of Pre-Code Law or Practice.

The Court of Appeals concluded that "for more than fifty years, the new value precept has been recognized as an important corollary or exception to the absolute priority rule" and that it "has been a major source of new funding in reorganizations for the past fifty years." App. to Pet. for Cert. at 19a, 21a. A brief review of the history of the new value doctrine demonstrates that the Court of Appeals misread the historical record.

Arguments in favor of a new value doctrine invariably rely on this Court's discussion of the issue in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939). In *Los Angeles Lumber*, a reorganization case under Section 77B of the Bankruptcy Act,[9] the Court drew on dicta from *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926), and suggested that in certain circumstances, stockholders could make a new contribution of capital in exchange for a reasonably equivalent ownership interest in the reorganized debtor. *See Los Angeles Lumber*, 308 U.S. at 117, 121-22. Because the contribution proffered by the stockholders in *Los Angeles Lumber* was insufficient as a matter of law, these discussions were dicta, as this Court has recognized previously. *See Ahlers*, 485 U.S. at 203.

The new value doctrine appeared in several other opinions of this Court in the 1940s, but in each case, the discussion of the doctrine was unnecessary to the resolution of the controversy. *See Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 85-86 (1942); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 529-30 & n.27 (1941); *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 454 (1940); *cf. Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-43 (1946) (discussing related issues in case involving investment by creditor in Chapter IX reorganization of public debtor). This Court was not alone, however, in its failure ever to apply the new value doctrine to the facts of a case. In the thirty-nine years from *Los Angeles Lumber* until the enactment of the Bankruptcy Code in 1978, no court concluded in a published decision that the new value doctrine permitted an exception to the absolute priority rule on the facts of a particular case. *See* 7 *Collier on Bankruptcy* ¶ 1129.04[4][c], at 1129-107 (Lawrence P. King ed., 15th ed. rev. 1997); Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991); Kenneth N. Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229, 241 (1990); John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963, 1016 (1989).

The historical pedigree of the new value doctrine, therefore, is sketchy at best, consisting entirely of theory and dicta. By contrast, in each of the cases in which this Court found that pre-Code law and practice were determinative, the Court concluded that *firmly established* pre-Code principles carried over into the post-1978 statutory scheme. *See Dewsnup*, 502 U.S. at 418 (describing pre-Code law on lien-stripping as "clearly established"); *Kelly*, 479 U.S. at 46 (recognizing "widely accepted" and "established" law on dischargeability of restitution orders); *Midlantic Nat'l Bank*, 474 U.S. at 501 (describing "well-recognized restrictions on a trustee's abandonment power").

The new value doctrine was not an established pre-Code practice; rather, it is similar to the purported pre-Code practice dismissed by this Court in *Ron Pair* as "an exception to an exception, recognized by only a few courts and often dependent on particular circumstances." *Ron Pair*, 489 U.S. at 246. Of the supposed rule proffered by the debtor in that case, the Court said: "It was certainly not the type of 'rule' that we assume Congress was aware of when enacting the Code; nor was it of such significance that Congress would have taken steps other than

[9] Section 77B was enacted by the Act of June 7, 1934, ch. 424, sec. 1, 48 Stat. 911, 912 (superseded 1938).

enacting statutory language to the contrary." *Id.*; *see also United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 381-82 (1988) ("The at best divided authority under Chapter XI [of the Bankruptcy Act] removes all cause for wonder that the alleged departure from it should not have been commented upon in the legislative history.") As discussed in the next subsection, Congress dealt with the new value doctrine precisely as it dealt with the rules at issue in *Ron Pair* and *Timbers of Inwood Forest*: it enacted statutory language to the contrary.

C. Congress Indicated Clearly That It Intended to Eliminate the New Value Doctrine When It Modified and Codified the Absolute Priority Rule, Without Exception, as Part of a Complete Overhaul of the Reorganization Provisions of the Bankruptcy Act.

Congress completely reworked the law of business reorganization when it enacted the Bankruptcy Code in 1978. *See Ron Pair*, 489 U.S. at 240 (stating that Congress "made significant changes in both the substantive and procedural laws of bankruptcy" and conducted "a substantial overhaul of the system"). As one part of this overhaul, Congress drew from the case law the rule of absolute priority, incorporated that rule into the new Bankruptcy Code in modified form, and made no mention of any exception to the rule for contributions by old equity. To the extent that the new value doctrine played any role in practice under the Bankruptcy Act,[10] Congress' handling of the absolute priority rule is a clear indication that Congress intended to abrogate the doctrine. *See Davenport*, 495 U.S. at 563-64 (holding that broad definition of "debt" and decision to limit exceptions to discharge in Chapter 13 revealed congressional

[10] For the remainder of this subsection, we assume for the sake of argument that the new value doctrine was an established element of practice under Chapter X of the Bankruptcy Act.

intent to allow discharge of restitution obligation); *Union Bank*, 502 U.S. at 160 (holding that substantial changes to pre-Code law favored conclusion that text of Bankruptcy Code reflected congressional intent).

The legal landscape of business reorganization under the Bankruptcy Act was strikingly different than it is today. Businesses seeking to reorganize could proceed under one of three chapters of the Bankruptcy Act, each of which had distinct rules and requirements. Describing the situation in 1977, the House Committee on the Judiciary reported that "chapter X . . . provides a complete financial restructuring of a corporation; chapter XI provides for arrangements and compositions for corporations, partnerships, and individuals; and chapter XII contains the procedures for arrangements for noncorporate entities involved in real estate." H.R. Rep. No. 95-595, at 221 (1977) (footnotes omitted), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6181. In the Bankruptcy Code, Congress selected elements from each of these chapters, added several new provisions, and created a single reorganization chapter, Chapter 11. *See generally Timbers of Inwood Forest*, 484 U.S. at 380-81 (discussing replacement of three reorganization chapters with Chapter 11).

In a reorganization under Chapter X of the Bankruptcy Act, a judge could not confirm a plan unless, among other things, it was "fair and equitable." Bankruptcy Act § 221(2) (11 U.S.C. § 621(2)) (repealed 1979). This Court read that language to require absolute priority, and not merely relative priority, among classes of creditors and interestholders, so that " 'to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation.' " *Los Angeles Lumber*, 308 U.S. at 116-17 (quoting *Kansas City Terminal Ry.*, 271 U.S. at 455).[11] In addition,

[11] As noted above, *Los Angeles Lumber* was decided under Section 77B of the Bankruptcy Act. However, the "fair and equitable" requirement applied in the same fashion under Chapter X. *See*

the "fair and equitable" requirement applied even if the overwhelming majority of creditors approved a reorganization plan that did not comply with absolute priority; a single dissatisfied creditor could upset an otherwise consensual reorganization. *See id.* at 114-15 (reversing confirmation based on objection by holder of less than one percent of bonds, despite approval of more than ninety percent of bondholders and stockholders).

When Chapters XI and XII were enacted, they too contained a "fair and equitable" requirement. Act of June 22, 1938, ch. 575, sec. 1, 52 Stat. 840, 911-12, 923 (adding Bankruptcy Act §§ 366, 472 (11 U.S.C. §§ 766, 872)) (repealed 1979); *United States Realty*, 310 U.S. at 452 (recognizing that Chapter XI incorporated "fair and equitable" test). In 1952, however, Congress deleted this requirement from Chapters XI and XII. *See SEC v. American Trailer Rentals Co.*, 379 U.S. 594, 610-11 (1965) (recognizing deletion of absolute priority rule from Chapter XI); *In re Perimeter Park Inv. Assocs., Ltd.*, 697 F.2d 945, 952 (11th Cir. 1983) (recognizing deletion of absolute priority rule from Chapter XII). At the same time, Congress added language to Chapters XI and XII stating specifically that confirmation should not be denied solely because old equity would retain its interest. Act of July 7, 1952, Pub. L. No. 82-456, secs. 35, 43, 66 Stat. 420, 433, 435 (amending Bankruptcy Act §§ 366, 472 (11 U.S.C. §§ 766, 872)) (repealed 1979). Congress surely was aware of this language, like the *Los Angeles Lumber* dicta, when it created Chapter 11 of the Bankruptcy Code, and one might expect that if Congress intended to import the new value doctrine into the Bankruptcy Code, it would have found this language helpful. Yet nothing remotely similar to this language appears anywhere in the Bankruptcy Code.[12]

Protective Comm. for Indep. Stockholders v. Anderson, 390 U.S. 414, 441 (1968); *Marine Harbor Properties*, 317 U.S. at 85-87.

[12] Similarly, Congress rejected the suggestion of the Commission on the Bankruptcy Laws of the United States that the new value doctrine be broadened to include non-monetary contributions by old equity. *See Ahlers*, 485 U.S. at 205-06.

In 1978, Congress was faced with the task of combining three reorganization chapters of the Bankruptcy Act, with differing approaches to the issue of absolute priority, into a single Chapter 11 of the new Bankruptcy Code. Chapter X contained a strict absolute priority rule that could not be waived by a class of affected creditors, along with an exception when old equity contributed new value. Chapters XI and XII contained no absolute priority rule at all, so that new value never became an issue. Congress responded by drawing the absolute priority rule from case law interpreting Chapter X, enacting the rule in statutory form for the first time, and applying it to all business reorganization cases, although in a modified fashion.

The Bankruptcy Code, the result of Congress' modification of pre-Code law, defines the "fair and equitable" requirement to include the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B). The rule applies only to classes of creditors that do not accept the plan. 11 U.S.C. § 1129(b)(1). A class is deemed to accept the plan if creditors holding two-thirds in amount and one-half in number of claims vote to accept. 11 U.S.C. § 1126(c). Dissenting members of an accepting class are not entitled to object on the basis of absolute priority; they are protected only by the best-interests-of-creditors test, which ensures that they receive at least as much as they would receive in a Chapter 7 liquidation. 11 U.S.C. § 1129(a)(7)(A). Thus, as commentators have recognized, if *Los Angeles Lumber* had been decided under the Bankruptcy Code, the absolute priority rule would not have been an issue, and this Court would not have overturned the confirmation of the plan. *See, e.g.*, Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. Rev. 975, 1010-11 (1997); Douglas G. Baird, *The Elements of Bankruptcy* 249 (1992).

The legislative history of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, evidences Congress' intent to rework the absolute priority principles of pre-Code law.[13] The House Report accompanying the bill that became the Bankruptcy Reform Act expressed dissatisfaction with the application of the absolute priority rule under Chapter X and concern about the lack of such a rule under Chapter XI. *See* H.R. Rep. No. 95-595, at 222-23 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6181-82. The Report then described the bill's version of the rule as "a *partial* application of the absolute priority rule now applied under Chapter X" and a "*partial* codification of the absolute priority rule." *Id.* at 224, 414 (emphasis added), 1978 U.S.C.C.A.N. at 6184, 6370. The floor leaders of the bill cautioned before final passage that "chapter 11 of the House amendment does not represent an extension of chapter X of current law or any other chapter of the Bankruptcy Act." 124 Cong. Rec. H11,100 (daily ed. Sept. 28, 1978) (statement of Rep. Don Edwards); 124 Cong. Rec. S17,417 (daily ed. Oct. 6, 1978) (statement of Sen. Dennis DeConcini).[14] They also explained the workings of the modified absolute priority rule, emphasizing that "the fair and equitable requirement applies only with respect to dissenting classes . . . unlike the fair and equitable rule contained in Chapter X" and explaining that "the plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) so long as no class junior to the dissenting class receives anything at all." 124 Cong. Rec. H11,104, 11,105 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17,420, 17,421 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini).

[13] Because of the significant differences among the reorganization chapters of the Bankruptcy Act, silence in the legislative history is not a helpful guide in determining congressional intent. *Cf. Timbers of Inwood Forest*, 484 U.S. at 381 ("[A]s far as the silence of the legislative history on the point is concerned, that would be no more strange with respect to alteration of the asserted Chapter XI rule than it would be with respect to alteration of the Chapters X and XII rule."). Nevertheless, because the legislative history reveals that Congress meant what it wrote in Section 1129(b) of the Bankruptcy Code, we discuss it here.

[14] These floor statements are reprinted in 1978 U.S.C.C.A.N., beginning at pages 6436 and 6505, and in part 4(f) of the appendix to *Collier on Bankruptcy* (15th ed. rev. 1997).

Congress carefully examined and significantly altered the absolute priority rule that prevailed in cases under Chapter X of the Bankruptcy Act. In light of Congress' devotion of substantial time and attention to the absolute priority rule, the logical conclusion is that Congress meant for the rule to be applied as it was enacted, without exception. *See Union Bank*, 502 U.S. at 160 ("[T]he fact that Congress carefully reexamined and entirely rewrote the preference provision in 1978 supports the conclusion that the text of § 547(c)(2) reflects the deliberate choice of Congress.").

In combining the three reorganization chapters of the Bankruptcy Act into a single chapter of the Bankruptcy Code, Congress faced other situations in which it had to decide among different rules prevailing under the various chapters of the Bankruptcy Act. For example:

- Chapter X of the Bankruptcy Act required the appointment of a disinterested trustee to manage any debtor with liabilities of $250,000 or more. Bankruptcy Act § 156 (11 U.S.C. § 556) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 604. In contrast, the debtor normally remained in possession of its assets under Chapters XI and XII. Bankruptcy Act §§ 332, 342, 432, 444 (11 U.S.C. §§ 732, 742, 832, 844) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 606. In the Bankruptcy Code, Congress drew on Chapters XI and XII and created a preference for debtor control except in extraordinary situations. *See* 11 U.S.C. §§ 1104(a), 1107(a).

- Any party in interest could propose a reorganization plan under Chapter X of the Bankruptcy Act. Bankruptcy Act §§ 167-170 (11 U.S.C. §§ 567-570) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 604. Only the debtor could propose an arrangement under Chapter XI. Bankruptcy Act §§ 306(1), 323 (11 U.S.C. §§ 706(1), 723) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 606. Congress created a hybrid rule in the Bankruptcy Code, giving the debtor-in-possession the exclusive right to propose a plan for the first 120 days after the entry of an order for relief and allowing the court to extend that exclusive period. 11 U.S.C. § 1121.

- A plan under Chapter X or Chapter XII could modify the rights of all creditors. Bankruptcy Act §§ 216, 461 (11 U.S.C. §§ 616, 861) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 604. Chapter XI, by contrast, was limited to the adjustment of unsecured debts. Bankruptcy Act §§ 306(1), 357 (11 U.S.C. §§ 706(1), 757) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 605. As enacted, Chapter 11 of the Bankruptcy Code followed Chapters X and XII of the Bankruptcy Act in allowing the debtor to modify the rights of all creditors. Bankruptcy Reform Act sec. 101, § 1123.[15]

Taken together with Congress' specific decisions about the absolute priority rule, these more general choices about the structure of the new reorganization chapter of the Bankruptcy Code demonstrate that Congress carefully thought through its decisions and enacted the absolute priority rule in the form it desired—without exception for new value contributed by old equity.

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[15] A 1994 amendment to the Bankruptcy Code limited the debtor's ability to modify the rights of a mortgagee of the debtor's principal residence. *See* 11 U.S.C. § 1123(b)(5). *See generally Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993) (interpreting identical language in Chapter 13).

III. AN EQUITY-ONLY NEW VALUE RIGHT IS INCONSISTENT WITH THE POLICIES UNDERLYING THE BANKRUPTCY CODE.

The decision of the Court of Appeals, allowing an equity-only new value right, ill-serves fundamental policies behind the Bankruptcy Code and is inconsistent with a number of other congressional policy decisions. "[T]o the extent that policy considerations are even relevant where the language of the statute is so clear," *Patterson*, 504 U.S. at 764, the Bank's reading of Section 1129(b) is preferable to the Court of Appeals'.

Two of the broadest goals of the reorganization provisions of the Bankruptcy Code are (1) to permit businesses to reorganize and remain viable, thereby preserving jobs and protecting investors, and (2) to maximize the value of the bankruptcy estate. *See Toibb*, 501 U.S. at 163; *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203-04 (1983); Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775, 787-89 (1987). An equity-only new value right does nothing to promote the first of these goals, for a business can be reorganized regardless of who owns it. If, as may be the case with certain businesses, old equity's ownership or management provides value to the business, creditors can agree to allow old equity to continue as owners, managers, or both. *See Kham & Nate's Shoes*, 908 F.2d at 1360. But permitting old equity to retain ownership over the objection of creditors does not promote the Bankruptcy Code's pro-reorganization policy. In the instant case, successful reorganization is an impossible goal in any event. The bankruptcy court found that even after ten years of operation, the reorganized Debtor would remain insolvent. *See* App. to Pet. for Cert. at 139a.

An equity-only new value right is flatly inconsistent with the policy of maximizing the bankruptcy estate. A plan of reorganization that prohibits any party other than old

equity from offering to purchase ownership of the reorganized business is, in effect, an auction to which only one bidder is invited. No bankruptcy judge would think it appropriate to conduct a one-party auction of property of the bankruptcy estate under 11 U.S.C. § 363. *See, e.g., M.R.R. Traders, Inc. v. Cave Atlantique, Inc.*, 788 F.2d 816, 818 (1st Cir. 1986) (concluding that bankruptcy court properly reopened auction after discovering that interested bidder did not receive notice of sale); *In re Abbotts Dairies of Penn., Inc.*, 788 F.2d 143, 149 (3d Cir. 1986) (remanding for determination whether purchaser of assets acted in good faith or colluded with debtor to freeze out potential bidders); *cf. In re Food Barn Stores, Inc.*, 107 F.3d 558, 562-63 (8th Cir. 1997) (holding that bankruptcy court should not "prequalify" bidders when soliciting assignees for debtor's unexpired lease under 11 U.S.C. § 365). An exclusive opportunity to purchase ownership interests in the reorganized debtor is no less inappropriate. No amount of scrutiny by the bankruptcy judge to determine whether old equity's proposed contribution is "substantial" or "reasonably equivalent" to the equity retained can resolve the fundamental difficulty that parties other than old equity may be willing to pay more for ownership than old equity offers.[16]

Another policy concern driving the enactment of the Bankruptcy Code was the perception that bankruptcy judges were too involved in the administration of cases under the Bankruptcy Act. The House Committee on the Judiciary explained:

[16] The Court of Appeals suggested that an equity-only new value right could enhance the value of a debtor's business, arguing that "exclusivity may be necessary simply because it may be easier to obtain additional funding from the old equity participants." App. to Pet. for Cert. at 21a. Certainly in many Chapter 11 cases, it will be most convenient for the debtor to obtain funding from old equity. Convenience does not equal necessity, however, nor does it justify barring others from attempts to provide funding in amounts greater than what old equity is willing to provide.

> When the Bankruptcy Act was adopted 80 years ago, the underlying premise was that the money of the estate was essentially a trust for the benefit of the bankrupt's creditors. Consequently, the creditors themselves should be entitled to supervise the collection and liquidation of the estate.

H.R. Rep. No. 95-595, at 91 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6053. Instead, the process was effectively controlled by the court, leading the Committee to state that "[c]reditor control in bankruptcy cases is a myth." *Id.* at 92, 1978 U.S.C.C.A.N. at 6053. Congress responded to this problem by, among other things, creating the United States Trustee system and altering the method of selecting members of creditors' committees. *See id.* at 100-05, 1978 U.S.C.C.A.N. at 6061-66. The Bankruptcy Code also gives creditors, and not bankruptcy judges or the Securities and Exchange Commission, the responsibility to determine what is in their best interests, especially in the area of plan confirmation. *Cf.* Bankruptcy Act §§ 172-175 (11 U.S.C. §§ 572-575) (repealed 1979) (requiring approval of plan by judge and, in larger cases, report by SEC before plan could be submitted to creditors and stockholders). A judge no longer may override the decision of a majority of a class of creditors to accept a plan that does not comply with the absolute priority rule, as this Court did in *Los Angeles Lumber*. Instead, "the Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which . . . fails to honor the absolute priority rule." *Ahlers*, 485 U.S. at 207.[17]

[17] Empirical evidence suggests that creditors frequently accept plans that would not satisfy the absolute priority rule. *See* Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990); Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989).

The equity-only new value right endorsed by the Court of Appeals turns this principle on its head. An equity-only new value right requires the bankruptcy judge to determine whether old equity's proffered contribution is "substantial," "reasonably equivalent" to the value of the reorganized debtor, and "necessary"—all without ever considering whether a creditor or some other person would be willing to pay the bankruptcy estate more to purchase ownership. The Court of Appeals' decision, therefore, both reinserts the bankruptcy judge into the confirmation process and excludes creditors from participating in deciding the fate of the debtor.

This Court concluded its discussion of equitable and policy considerations in *Ahlers* as follows:

> The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code. 11 U.S.C. § 1126(c). Here, the principal creditors entitled to vote in the class of unsecured creditors (*i.e.*, petitioners) objected to the proposed reorganization. This was their prerogative under the Code, and courts applying the Code must effectuate their decision.

Ahlers, 485 U.S. at 207. The Court's concerns in *Ahlers* are equally valid in the case at bar. Policy considerations support the plain language of Section 1129(b) of the Bankruptcy Code, which prohibits an equity-only new value right and requires reversal of the judgment of the Court of Appeals.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed and the case should be remanded for further proceedings in the bankruptcy court.

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BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

JOINT BRIEF OF AMICI CURIAE IN SUPPORT OF THE RESPONDENT

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TABLE OF CONTENTS

Page

I. INTERESTS OF *AMICI CURIAE* 1

II. INTRODUCTION AND SUMMARY OF ARGUMENT 3

III. ARGUMENT 8

A. The Statutory Codification Of The "Fair And Equitable" Requirement Does Not Prohibit "New Value" Plans 8

1. The Statutory Context Of Plan Confirmation 8

2. The Plain Language Of Section 1129(b)(2)(B)(ii) Is Dispositive And Does Not Prohibit Equity Holders From Receiving New Equity Under A Plan In Exchange For A New Capital Contribution 9

B. The "New Value" Principle Was Recognized In Pre-Code Case Law Construing The "Fair And Equitable" Requirement And Was Not Abrogated By The Code... 13

1. The Recognition Of The New Value Principle As A Corollary To The "Fair And Equitable" Requirement Under The Former Bankruptcy Act..... 13

2. The Codification Of The "Fair And Equitable" Requirement In The Bankruptcy Code Did Not Abrogate The New Value Principle..... 18

TABLE OF CONTENTS – Continued

Page

a. The Code Should Not Be Read To Abrogate The Pre-Code Interpretation Of The "Fair And Equitable" Requirement, Absent Clear Evidence Of A Contrary Intent By Congress 18

b. The Legislative History Of The Code Manifests No Intent To Eliminate The New Value Principle ... 19

c. The Absence Of An Express New Value "Exception" In Section 1129(b) Of The Code Does Not Diminish The Vitality Of The New Value Principle 21

d. The Fact That The "Fair And Equitable" Requirement Now Applies To Dissenting Classes, Rather Than To Dissenting Creditors, Does Not Abrogate The Pre-Code Interpretation Of That Requirement 21

C. The Fact That A Plan Provides For Existing Equity Holders Alone To Make The New Capital Contribution If The Plan Is Confirmed Does Not Result In The Receipt Of Any Property "On Account Of" An Existing Equity Interest In The Debtor... 23

D. Policy Considerations Favor The Continued Vitality Of The New Value Principle 26

IV. CONCLUSION 30

TABLE OF AUTHORITIES

Page

CASES

In re 47th and Belleview Partners, 95 B.R. 117 (Bankr. W.D. Mo. 1988) 29

In re Bioplasty, Inc., 155 B.R. 495 (Bankr. D. Minn. 1993) 13

In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993), *cert. dismissed*, 513 U.S. 18 (1994) 10

Carson Nugget, Inc. v. Green (In re Green), 98 B.R. 981 (Bankr. 9th Cir. 1989) 29

Case v. Los Angeles Lumber Products, 308 U.S. 106 (1939) ..... *passim*

Cohen v. De la Cruz, 118 S. Ct. 1212 (1998) 13, 18

Consolidated Rock Products v. Du Bois, 312 U.S. 510 (1941) 7, 15

Dewsnup v. Timm, 502 U.S. 410 (1992) 6, 14, 19

In re Donahoe's, Inc., 19 F. Supp. 441 (D. Del. 1937) 17

In re Dowden, 143 B.R. 388 (Bankr. W.D. La. 1989) 29

Ecker v. Western Pacific R.R., 318 U.S. 448 (1943)..... 15

In re El Paso Refinery, L.P., 178 B.R. 426 (Bankr. W.D. Tex. 1995) 13

In re Evenson, 165 B.R. 27 (Bankr. E.D. Mich. 1994) 13

In re Four Seasons Nursing Centers, 472 F.2d 747 (10th Cir. 1973)..... 17

Heald v. District of Columbia, 254 U.S. 20 (1920)..... 23

TABLE OF AUTHORITIES – Continued

Page

Kansas City Terminal Railway v. Central Union Trust Co., 271 U.S. 445 (1926) 14, 15

Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990) 20

In re King Resources Co., 651 F.2d 1326 (10th Cir. 1980) 16

Lorillard v. Pons, 434 U.S. 575 (1978) 23

Marine Harbor Properties v. Manufacturer's Trust Co., 317 U.S. 78 (1942) 15

Mason v. Paradise Irrigation District, 326 U.S. 536 (1946) 7, 15

Mecca Temple v. Darrock, 142 F.2d 869 (2d Cir. 1944) 17

Metropolitan Holding Co. v. Weadock, 113 F.2d 207 (6th Cir. 1940) 17

Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 (1986) ... 7, 18, 19

In re Mortgage Investment Co., 111 B.R. 604 (Bankr. W.D. Tex. 1990) 29

In re Muskegon Motor Specialties, 366 F.2d 522 (6th Cir. 1966) 17

N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513 (1984) ..8, 26

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 16, 21, 22

O'Gilvie v. United States, 117 S. Ct. 452 (1996) ... *passim*

TABLE OF AUTHORITIES – Continued

Page

Pennsylvania Department of Public Welfare v. Davenport, 495 U.S. 552 (1990) ..... *passim*

In re Resorts International, Inc., 145 B.R. 412 (Bankr. D.N.J. 1990) 28

In re SLC Ltd., V, 137 B.R. 847 (Bankr. D. Utah 1992) 20

In re Sawmill Hydraulics, Inc., 72 B.R. 454 (Bankr. C.D. Ill. 1987) 29

Securities & Exch. Commission v. American Trailer Rentals Co., 379 U.S. 594 (1965) 19

In re Shepcaro, 144 B.R. 3 (Bankr. D. Mass. 1992) 21

In re Snyder, 967 F.2d 1126 (7th Cir. 1992) ..... *passim*

In re Tallahassee Associates, L.P., 132 B.R. 712 (Bankr. W.D. Pa. 1991) 29

In re U.S. Truck Co., 800 F.2d 581 (6th Cir. 1986) 27

United States v. Nordic Village, Inc., 503 U.S. 30 (1992) 11

Unit[illegible] States v. Ron Pair Enterprises, 489 U.S. 235 (1[illegible]) 9

United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) 8, 26

In re Universal Lubricating System, 59 F. Supp. 171 (W.D. Pa.), *aff'd*, 150 F.2d 832 (3d Cir. 1945) 17

In re Woodscape Ltd. Partnership, 134 B.R. 165 (Bankr. D. Md. 1991) 29

In re Yasparro, 100 B.R. 91 (Bankr. M.D. Fla. 1989) 29

TABLE OF AUTHORITIES – Continued

Page

STATUTES & RULES

11 U.S.C. § 621 (repealed) 14, 22

11 U.S.C. § 1121(a) 24

11 U.S.C. § 1121(c) 4, 24

11 U.S.C. § 1123(a)(5)(J) 4

11 U.S.C. § 1124 8

11 U.S.C. § 1126(c) 8

11 U.S.C. § 1129 ..... *passim*

26 U.S.C. § 104(a)(2) 11

OTHER AUTHORITIES

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., lst Sess., pt. I, 258-59 20

4 *Norton Bankruptcy Law & Practice* § 93:13 at 93-46 n.36 (2d ed. 1993) 17

6A *Collier on Bankruptcy* ¶ 11.06 at 229-31 (14th ed. rev. 1977) 17

Blacks Law Dictionary 454 (6th ed. 1990) 16

H.R. 31 & 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary, 94th Cong., 1st & 2d Sess., Ser. 27, App. 248 (1975) 20

I.
INTERESTS OF *AMICI CURIAE*[1]

The Credit Associations,[2] National Small Business United ("NSBU"), the National Apartment Association ("NAA"), and the Commercial Investment Real Estate Institute ("CIREI") file this brief as *amici curiae* in support of Respondent 203 North LaSalle Street Partnership ("LaSalle"). The parties have consented to the filing of this Brief, and their written consent is filed together with this Brief.

The Credit Associations consist of twenty-one regional associations of businesses that extend commercial credit. They have in the aggregate over 15,600 members, serve a diverse spectrum of industry credit groups, and generally represent the interests of unsecured creditors. When a business debtor finds itself in financial trouble, members of the Credit Associations and other similar businesses often make up a significant component of the debtor's unsecured creditors.

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[1] This Brief was authored by counsel for *amici curiae*. No entity other than *amici curiae* and their counsel made any monetary contribution to its preparation or submission.

[2] The Credit Associations are Credit Managers Association of California; Georgia Association of Credit Management d/b/a NACM-Southeast Unit; Spokane Merchants Association d/b/a NACM Inland Northwest; Indiana Association of Credit Management; NACM Louisiana, Inc.; NACM-Carolinas, Inc.; NACM-Ohio; NACM South Central Region, Inc.; NACM of Florida, Inc.; NACM Oklahoma Division, Inc. d/b/a NACM Midamerica; NACM of Wisconsin, Inc.; NACM Mid-Atlantic Chapter, Inc.; NACM-Western Pennsylvania; NACM/Chicago Midwest; NACM-St. Louis; NACM Southwest; NACM of Arizona, Inc.; NACM-Great Lakes; NACM – Upstate New York; NACM East Tennessee, Inc.; and NACM – National Capital Region.

NSBU has been an advocate for small businesses since 1937. NSBU's more than 65,000 members through its chapters and affiliates include carpenters, consultants, manufacturers, retailers, grocers, designers, and other small businesses that comprise the backbone of the American economy. NSBU is a non-partisan advocacy group that constructively engages its members in legislative and regulatory initiatives that affect the small business community.

NAA is the nation's largest industry-wide, nonprofit trade association devoted solely to the needs of the apartment industry. NAA represents approximately 26,000 owners, builders, investors, developers, managers, and other rental housing professionals who hold responsibility for more than 3.4 million apartment households nationwide.

CIREI is affiliated with the National Association of Realtors and is dedicated to education and excellence in the commercial real estate profession. Its membership consists of approximately 6,000 brokers, bankers, consultants, property and asset managers, appraisers, investment counselors, attorneys, accountants, and other real estate professionals who serve the needs of commercial real estate owners, investors, and users.

Unsecured creditors, suppliers, small businesses, tenants, and real property managers and investors such as the members and clients of *amici curiae* benefit from the successful reorganization of a financially troubled debtor. A successful reorganization typically increases the recovery on unsecured claims, facilitates investments of new capital improvements into the debtor and its assets, and preserves a source of business for the debtor's creditor-suppliers. A successful reorganization also helps preserve jobs for the employees of both debtors and their suppliers.

Amici curiae recognize that the ability of a financially troubled debtor to reorganize often depends on its ability to raise new capital, either to help satisfy creditor claims or to provide working capital for the reorganized enterprise. The holders of existing equity (*i.e.*, current owners) may be the most likely and logical, if not the only, source of such necessary new capital. Consequently, a principle of law that unduly curtails the availability of new capital for troubled businesses in the context of "new value" plans of reorganization would undermine the ability to reorganize such businesses and would make "distress sale" liquidations more likely.

The result that Petitioner Bank of America NT&SA ("Bank") seeks threatens just such an outcome, because it would prohibit the confirmation of a plan of reorganization based on a new capital infusion from existing equity owners whenever a single creditor class (or, as in this case, a single large creditor) votes to reject the plan, regardless of the wishes of the debtor's other creditors. To avoid this result, *amici curiae* support the decision of the Court of Appeals below and urge its affirmance.

II.

INTRODUCTION AND SUMMARY OF ARGUMENT

Bankruptcy Code[3] section 1129(b)(2)(B)(ii) provides that a plan of reorganization may be confirmed as "fair and equitable" even when a nonaccepting class of unsecured claims will not be satisfied in full, as long as the holders of junior equity interests do not receive or retain any property under the plan *"on account of such junior . . . interest[s]."* The Court of Appeals below held that when existing equity holders contribute new value

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[3] *See* 11 U.S.C. §§ 101-1330.

that is substantial and necessary to the reorganization, those equity holders may receive new equity in the reorganized debtor pursuant to a plan of reorganization, not "on account of" their existing junior equity interests, but rather "on account of" their new value contribution.

The decision of the Court of Appeals should be affirmed because it properly follows over a half-century of established case law and is consistent with the plain statutory language, the legislative history, and sound public policy.

1. By its plain language, Bankruptcy Code section 1129(b)(2)(B)(ii) only prohibits existing equity holders from receiving or retaining property *"on account of"* their *existing equity interests*. Nothing in the statutory language prohibits existing owners from receiving new equity under a plan "on account of" a *new capital investment* (rather than "on account of" their existing "junior . . . interest[s]"). Moreover, nothing in the Code otherwise prohibits existing owners from proposing or receiving value under a plan. *See* 11 U.S.C. §§ 1121(c), 1123(a)(5)(J). The plain language of the statute thus permits new value plans and should be dispositive. *See, e.g., Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990).

2. The Bank proposes an overly broad interpretation of the phrase "on account of" that, contrary to its plain meaning, would bar existing equity holders from receiving any consideration under a new value plan whenever there may exist even the slightest, tangential connection between the equity holders' participation in the plan and their existing equity interests. Brief of Petitioner ("Petr. Br.") at 21-22. In so doing, the Bank ignores this Court's interpretation of identical statutory language in *O'Gilvie v. United States*, 117 S. Ct. 452, 454-55 (1996), which held that the phrase "on account of" requires a "stronger

causal connection" than merely a " 'but-for' connection." Furthermore, the Bank's interpretation is inconsistent with the usage of the phrase "on account of" in other provisions of section 1129(b)(2) and throughout the Bankruptcy Code.

3. The Bank's interpretation of section 1129(b)(2)(B)(ii) would render the "on account of" language meaningless by effectively barring existing equity holders from ever participating in new value reorganizations. Congress certainly *could* have achieved this result by drafting section 1129(b)(2)(B)(ii) to provide that *"the holder of any interest that is junior to the claims of a nonconsenting senior class shall never receive or retain under the plan any property"*, thereby omitting any reference to the receipt or retention of property specifically *"on account of such junior . . . interest."* That is not, however, the statute Congress drafted. Rather, the simple, straightforward language of section 1129(b)(2)(B)(ii) only prohibits the holders of existing equity from receiving property "on account of" their existing equity interests; it does not prohibit existing equity holders from receiving property "on account of" something other than their equity such as a contribution of new value.

4. The Bank's contention that LaSalle's existing equity holders were improperly granted the "exclusive opportunity" to purchase equity in the reorganized debtor is equally unavailing. According to the Bank, this "opportunity" constituted an "exclusive option" that itself was "property" distributed "on account of" existing equity interests. However, the new value contribution under LaSalle's plan was not an *option*, but rather was an *obligation* that LaSalle's equity holders were *required* to fulfill in order for the plan to become effective. *See* Joint App. at 37 (the "partners *shall* make, or cause to be made, the capital contributions to the Reorganized Debtor")

(emphasis added). On the plan's effective date, all existing equity interests were cancelled, and the only "property" that the contributing equity holders received under the plan was the new equity interests obtained on account of their new value contributions.

5. The Bank concedes that new value plans may be proper as long as both creditors and equity holders are allowed to participate in an "open auction" to contribute new value. Petr. Br. at 11 n.6. In so conceding, the Bank distinguishes between those new value plans in which existing equity holders are the exclusive source of new capital versus those in which creditors may also contribute new capital. The Bankruptcy Code, however, does not support such a distinction. If, as the Bank concedes, equity holders may contribute new value on a nonexclusive basis, nothing in the Bankruptcy Code prohibits equity holders from so contributing on an exclusive basis. In either case, the "property" the equity holders receive in the form of new equity in the reorganized debtor is "on account of" their new value contribution, whether nonexclusive or exclusive, and not "on account of" their existing equity holdings.

6. To the extent that the phrase "on account of" may be ambiguous, *see O'Gilvie*, 117 S. Ct. at 454 ("the phrase 'on account of' does not unambiguously define itself"), this Court should look to bankruptcy law as it existed prior to the Bankruptcy Code's enactment, *see Dewsnup v. Timm*, 502 U.S. 410, 419-20 (1992). Contrary to the Bank's assertion, the new value principle was not *"dicta"* prior to the Code's enactment. A half-century of prior case law applying the "fair and equitable" requirement clearly established that equity holders of an insolvent debtor could receive equity interests in the reorganized debtor in exchange for a necessary contribution of new value, in

money or money's worth, that represented a fair equivalent for the equity that would be received under the plan. *See, e.g., Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-42 (1946); *Consolidated Rock Prods. v. Du Bois*, 312 U.S. 510, 529 n.27, (1941); *Case v. Los Angeles Lumber Prods.*, 308 U.S. 106, 121-22 (1939).

7. When Congress intends for legislation to change existing law, it must make that intent specific. *See, e.g., Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986). Here, the statutory codification of the "fair and equitable" requirement in section 1129(b) fails to evince any congressional intent to abrogate the "new value" principle; rather, that language only prohibits the holder of a junior interest from receiving property "on account of such junior . . . interest," not from receiving property "on account of" a new capital contribution. Moreover, the statute explicitly uses "words of art" from the former Bankruptcy Act – "fair and equitable" – which were interpreted to include the "new value" principle. *See Case*, 308 U.S. at 121-22.

8. Similarly, nothing in the voluminous legislative history of the Bankruptcy Code suggests that Congress intended to rip the "new value" principle from the fabric of reorganization precedent. Although Congress did reject an effort to dilute the requirements that had to be satisfied in order to invoke the new value principle (and thus Congress' attention was directed to that principle), the legislative history reflects no intention to abrogate the new value principle. *See In re Snyder*, 967 F.2d 1126, 1129-30 (7th Cir. 1992) (containing extensive discussion of legislative history).

9. The "new value" principle fosters Congress' policy of rehabilitation that underlies chapter 11 reorganizations by encouraging the infusion of new equity capital into chapter 11 debtors. "[T]he policy of Chapter 11 is to

permit successful rehabilitation of debtors . . . . " *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984). "By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return to its owners. Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.' " *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) (citations omitted). A *per se* rule prohibiting new value plans, however, would prevent reorganizations in the substantial number of cases in which the availability of a new capital infusion from existing owners is of critical importance.

III.

ARGUMENT

A. The Statutory Codification Of The "Fair And Equitable" Requirement Does Not Prohibit "New Value" Plans.

1. The Statutory Context Of Plan Confirmation.

Bankruptcy Code section 1129(a) sets forth thirteen separate requirements that must be satisfied in order to confirm a chapter 11 plan. Included among these requirements is that each impaired class of claims or interests must have "accepted" the plan. 11 U.S.C. § 1129(a)(8).[4] A class of creditors "accepts" a plan if the plan is accepted by creditors holding a majority in number *and* two-thirds in amount of the allowed claims in the class that actually vote on the plan. 11 U.S.C. § 1126(c). Thus, a group of

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[4] Generally, a class is "impaired," and its acceptance therefore required under section 1129(a)(8), if its legal, equitable, or contractual rights are altered by the plan. *See* 11 U.S.C. § 1124.

creditors (or even a single large dissenting creditor) that holds more than one-third of the claims in a creditor class can prevent acceptance of the plan by that class, even if a majority of the members holding a majority of the claims in the class vote to accept the plan.

Even if one or more impaired creditor classes do not accept the plan, however, the plan nonetheless may be confirmed under certain statutorily prescribed circumstances. If the plan satisfies all of the confirmation requirements other than the voting requirement, the court "*shall confirm* the plan notwithstanding the requirement of [section 1129(a)(8)] if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1) (emphasis added). Thus, in order to foster the chapter 11 goal of reorganization, Congress determined that even if a holdout class (or a large holdout creditor who can veto class acceptance) does not accept a plan, the plan *shall* still be confirmed if, among other things, it is fair and equitable to a nonconsenting creditor class.

2. The Plain Language Of Section 1129(b)(2)(B)(ii) Is Dispositive And Does Not Prohibit Equity Holders From Receiving New Equity Under A Plan In Exchange For A New Capital Contribution.

The meaning of the statutory codification of the "fair and equitable" requirement "begins with the language of the statute itself." *Davenport*, 495 U.S. at 557-58. Where, as here, the language of the statute is plain, this is also where the inquiry should end. *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) ("the sole function of the courts is to enforce [the statute] according to its terms") (quotation omitted).

Section 1129(b)(2)(B)(ii) provides that a plan may be "fair and equitable" with respect to a dissenting class of unsecured claims if:

> the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan *on account of such junior claim or interest* any property (emphasis added).

By its plain terms, section 1129(b)(2)(B)(ii) does not impose a *per se* prohibition against economic participation by exisiting equity in the reorganized debtor; instead, it prohibits such participation only when it is *"on account of such junior claim or interest."*

The insertion of this limiting language makes it clear that Congress did not intend to preclude existing equity holders from participating as new equity holders in the reorganized debtor on account of a new capital contribution:

> Had Congress intended that old equity never receive any property under a reorganization plan where senior claim classes are not paid in full, it could simply have omitted the "on account of" language from section 1129(b)(2)(B)(ii). We would then be left with an absolute prohibition against former equity owners receiving or retaining property in the reorganized debtor in such circumstances. The expansive reading of the phrase "on account of such junior claim or interest" suggested by [the Bank] would lead to the identical result, thus rendering the disputed phrase superfluous. . . . Congress must have intended the "on account of" language to have some significant meaning as well as some particular limiting effect.

In re Bonner Mall Partnership, 2 F.3d 899, 909 (9th Cir. 1993), *cert. dismissed*, 513 U.S. 18 (1994).

"[A] statute must, if possible, be construed in such fashion that every word has some operative effect."

United States v. Nordic Village, Inc., 503 U.S. 30, 36 (1992). The Bank, however, advocates such an expansive reading of "on account of" as to render the phrase meaningless. According to the Bank, as long as there is *any* conceivable relationship between the equity holders' existing interests and the interests they will receive in exchange for new value, then the new value plan fails the "fair and equitable" test. Petr. Br. at 21-22. Since one of the reasons that existing equity holders often desire to participate in new value plans is because of their long-standing knowledge of and relationship with the debtor, the Bank's expansive definition would effectively bar equity holders from ever participating in such plans. By its very terms, however, section 1129(b)(2)(B)(ii) clearly contemplates the possibility of existing equity holders participating in at least some reorganization plans even when a nonassenting senior class is not satisfied in full, as long as those holders do not receive or retain any consideration "on account of" their existing equity interests.

This Court recently resolved conflicting interpretations of the statutory phrase "on account of" by rejecting an expansive interpretation such as that offered by the Bank in favor of a strict, causal meaning. *See O'Gilvie*, 117 S. Ct. at 453-54. In *O'Gilvie*, taxpayers contended that punitive damage awards were not taxable under a statute exempting from federal income tax any "damages received . . . on account of personal injuries or sickness." 26 U.S.C. § 104(a)(2). According to the taxpayers, the punitive damages were tax exempt since they were awarded because of (and thus, they contended, "on account of") their personal injuries.

In rejecting the taxpayers' argument, the Court held that although it was true that the taxpayers would not have received punitive damage awards "but for" their injuries, this indirect causal connection was insufficient to

make the awards "on account of" their injuries. While recognizing that "the phrase 'on account of' does not unambiguously define itself", 117 S. Ct. at 454, the Court held that the "interpretation [that] gives the phrase 'on account of' a meaning consistent with the dictionary definition" is one that "impose[s] a stronger causal connection" that is "more than a 'but-for' connection," *id.* at 454-55.[5] Rather, in order for damages to be "on account of" a personal injury, they must be those actual damages that arose "by reason of" or "for the sake of" that injury. *Id.* at 455.

Under a new value plan, the reason that existing equity holders may receive equity in the reorganized debtor is for the sake of (and thus "on account of") their contribution of necessary and substantial new capital. Although the equity holders might have had no desire to contribute new value "but for" their prior equity holdings, following *O'Gilvie* the mere fact that a prior equity holder participates in a new value plan does not make such participation "on account of" the holder's existing equity interests.

An interpretation of "on account of" that requires a close causal connection is consistent with the use of that phrase in other provisions of Bankruptcy Code section 1129, as well as other sections of the Bankruptcy Code.

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[5] The Solicitor General argued to this Court in *O'Gilvie* "the fact that personal injury is a prerequisite to punitive damages does not lead to the conclusion that the punitive damages were 'on account of' the plaintiff's injuries." 1996 W.L. 325323 at 14. Applying this reasoning, the fact that a plan provides that holding an existing ownership interest may be prerequisite to contributing new value does not lead to the conclusion that the new equity in the reorganized debtor obtained in exchange for that new value was "on account of" the existing ownership interest.

The phrase "on account of" occurs *eight* separate times in section 1129, specifically in subsection (b)(2)(B)(ii), which is at issue here, subsection (b)(2)(C)(ii), which provides analogous protections for classes of senior equity interests, and in six provisions that specifically authorize or require various types of distributions to creditors and equity holders "on account of" their existing claims and interests, specifically subsections (a)(7)(A)(ii), (a)(7)(B), (a)(9)(c), (b)(2)(A)(i)(II), (b)(2)(B)(i), and (b)(2)(C)(i). The *only* logical meaning of "on account of" that could apply uniformly in each of these eight instances is "in consideration of" or "for the sake of", and not simply "but for." *See Cohen v. De la Cruz*, 118 S. Ct. 1212, 1217 (1998) (applying "the presumption that equivalent words have equivalent meaning when repeated in the same statute" to Bankruptcy Code). This is also the most widely accepted meaning given to the phrase "on account of" throughout the Bankruptcy Code. *See, e.g., In re El Paso Refinery, L.P.*, 178 B.R. 426, 449 (Bankr. W.D. Tex. 1995) ("The phrase 'on account of' [as used in Bankruptcy Code section 547(b)] carries with it the connotation of causation."); *In re Evenson*, 165 B.R. 27, 28 (Bankr. E.D. Mich. 1994) (" 'on account of' [as used in section 522(d)(10)(E)] refers to payment rights which are 'triggered by' the events listed in the statute"); *In re Bioplasty, Inc.*, 155 B.R. 495, 498 (Bankr. D. Minn. 1993) ("on account of" means "as compensation for" in section 547(b)).

B. The "New Value" Principle Was Recognized In Pre-Code Case Law Construing The "Fair And Equitable" Requirement And Was Not Abrogated By The Code.

1. The Recognition Of The New Value Principle As A Corollary To The "Fair And Equitable" Requirement Under The Former Bankruptcy Act.

Were this Court to find that "the phrase 'on account of' does not unambiguously define itself" in the context

of section 1129(b)(2), *see O'Gilvie*, 117 S. Ct. at 454, it should then turn to precedents decided under the former Bankruptcy Act for guidance, *see Dewsnup*, 502 U.S. at 419-20; *Davenport*, 495 U.S. at 563. These precedents, which include at least five separate decisions of this Court, unquestionably established the existence of the new value principle under the Act.

As in the current Bankruptcy Code, the reorganization provisions of the prior Bankruptcy Act included the "fair and equitable" requirement.[6] Although the "fair and equitable" requirement was not defined in the prior statute, courts interpreted that requirement to incorporate the so-called "absolute priority" rule, which provided that creditors of a debtor were entitled to priority in consideration of their claims over the rights of stockholders in consideration of their junior equity interests. *See Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).

Because the "absolute priority" rule provided that creditors were to be compensated for their claims to the debtor's enterprise value before equity could participate in that value on account of their equity interests, there was nothing in that rule, *per se*, that prohibited equity holders from buying ownership interests in the reorganized debtor in exchange for a contribution of fresh capital. Consequently, at the same time this Court was articulating and developing the "absolute priority" rule, the Court also recognized that this rule did not prevent existing equity holders from acquiring new equity in the

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[6] When Congress enacted the reorganization provisions of section 77B and, thereafter, Chapter X of the former Bankruptcy Act in the 1930's, it included the statutory requirement that a plan be "fair and equitable." *See* Bankruptcy Act § 221(2), codified in former 11 U.S.C. § 621(2) (repealed 1978).

reorganized debtor in exchange for a new capital contribution as long as the fresh capital met certain requirements that were designed to ensure that existing values were not being diverted from creditors to equity holders:

> It has long been recognized in reorganization law that those who put new money into the distressed enterprise may be given a participation in the reorganization plan reasonably equivalent to their contribution. That rule is based on practical necessities. Without the inducement new money could not be obtained.

Mason, 326 U.S. at 541-42 (citation omitted).

This Court made clear no less than five separate times that, by the mid-1940's, it viewed the new value principle as part of the fabric of reorganization practice. *See Case*, 308 U.S. at 117, 121-22; *Consolidated Rock Prods.*, 312 U.S. at 529 n.27; *Marine Harbor Properties v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942) (discussing new value principle as the "rule" of *Case*); *Ecker v. Western Pac. R.R.*, 318 U.S. 448, 486-87 (1943) (applying new value principle to affirm confirmation of plan that provided enhanced treatment for creditor that contributed new value); *Mason*, 326 U.S. at 541-43.

The Court's repeated recognition of the new value principle was based upon the practical need for new funds in a reorganization case and the fact that existing equity holders often are the most logical source of such funds:

> Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them, unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them.

Kansas City Terminal Ry., 271 U.S. at 455.

The Bank attempts to dismiss this Court's repeated recognition of the new value principle as "mere *dicta*". *See*

Petr. Br. at 33-34. To the contrary, at least in *Case*, this Court's detailed consideration of the limits of the new value principle was essential to the outcome.[7] The plan in *Case* proposed that existing stockholders would receive approximately 23% of the equity in the reorganized debtor in recognition of, among other things, the value the stockholders provided in terms of " 'their familiarity with the operation' of the business and their 'financial standing and influence in the community.' " 308 U.S. at 112. This Court recognized the new value principle, but found that this proposed "contribution" flunked the new value principle's requirements because it could not "be translated into money's worth reasonably equivalent to the participation accorded the old stockholders." *Id.* at 122.[8]

Moreover, it is clear that the lower courts routinely treated this Court as having established the rule of the new value principle. *See, e.g., In re King Resources Co.*, 651 F.2d 1326, 1339 (10th Cir. 1980) (Bankruptcy Act case holding that "[u]nder certain circumstances stockholders may participate in a plan of reorganization of an insolvent debtor, but only if they make a fresh contribution of

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[7] *"Dictum"* is commonly defined as "an opinion concerning some rule of law or legal proposition not necessarily involved nor essential to determination of the case in hand." *Blacks Law Dictionary* 454 (6th ed. 1990). Under this standard, the principles articulated in *Case* must not be regarded as *dicta*, because there would have been no need for the Court in *Case* to address the issue of why the plan failed to satisfy the new value participation test unless the Court first *held* that the new value principle exists and that the absolute priority rule did not, *per se*, prohibit such participation.

[8] Although this Court subsequently did refer to the new value discussion in *Case* as *"dicta"* in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 205 (1988) (the reference itself arguably in *dicta*), the Court did not explain the basis of its characterization.

money or money's worth"); *In re Four Seasons Nursing Centers*, 472 F.2d 747, 750 (10th Cir. 1973) (shareholders of insolvent debtor must "introduce[ ] fresh money" in order to participate in plan); *In re Muskegon Motor Specialties*, 366 F.2d 522, 525 (6th Cir. 1966) ("if the corporation is insolvent, . . . then there is no room in the new corporation for old shareholders unless they contribute fresh capital"); *Mecca Temple v. Darrock*, 142 F.2d 869, 872 (2d Cir. 1944) (stockholders of insolvent debtor may participate in plan by providing "some fair compensating advantage" to creditors); *Metropolitan Holding Co. v. Weadock*, 113 F.2d 207, 209 (6th Cir. 1940) (affirming denial of confirmation in an insolvent case because the stockholders did not "contribute the reasonable equivalent in money or money's worth"). Leading commentators also recognized the new value principle as existing prior to the Bankruptcy Code's enactment. *See* 6A *Collier on Bankruptcy* ¶ 11.06 at 229-31 (14th ed. rev. 1977) (discussing new value principle and cases recognizing it); 4 *Norton Bankruptcy Law & Practice* § 93:13 at 93-46 n.36 (2d ed. 1993) (rejecting argument that new value principle was mere *dicta* under the Bankruptcy Act).

Finally, contrary to the Bank's assertion, reported decisions *did* confirm new value plans in which shareholders received equity prior to the current Code's enactment. *See, e.g., In re Universal Lubricating Sys.*, 59 F. Supp. 171, 172 (W.D. Pa.) (after plan that allowed shareholders to participate was rejected as not fair and equitable, court confirmed amended plan that allowed equity holders to participate by contributing new value), *aff'd* 150 F.2d 832 (3d Cir. 1945); *In re Donahoe's, Inc.*, 19 F. Supp. 441 (D. Del. 1937) (confirming plan that authorized common shareholders to receive equity on account of new value over the objection of senior preferred shareholders). The Bank's claim that it cannot find any more such reported

decisions is no indication that courts did not approve new value plans. Rather, it reflects the fact that the new value principle was so well established by the mid-1940's as to not justify further reported decisions.

2. The Codification Of The "Fair And Equitable" Requirement In The Bankruptcy Code Did Not Abrogate The New Value Principle.

a. The Code Should Not Be Read To Abrogate The Pre-Code Interpretation Of The "Fair And Equitable" Requirement, Absent Clear Evidence Of A Contrary Intent By Congress.

In light of the pre-Code case law that interpreted the "fair and equitable" requirement to permit the continued participation by existing equity in a reorganized debtor in exchange for a necessary and substantial new capital contribution, there is no basis for reading into the current statutory codification of the "fair and equitable" requirement a *per se* prohibition on "new value" plans that is not found in the plain language of the statute itself. "We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 495 U.S. at 563; *see also De la Cruz*, 118 S. Ct. at 1218. "[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." *Midlantic*, 474 U.S. at 501 (citation omitted)[9]. "[T]his Court has been reluctant to

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[9] The pre-Code case law that addressed the new value principle provides a far firmer basis for finding a settled pre-Code judicial interpretation than did the pre-Code precedent relied on by the Court in *Midlantic*. In *Midlantic*, the Court found sufficient evidence of the establishment of a judicially

accept arguments that would interpret the [Bankruptcy] Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup*, 502 U.S. at 419.

The words "fair and equitable" as used in section 1129(b)(2) were "words of art" under the Bankruptcy Act. *Securities & Exch. Comm'n v. American Trailer Rentals Co.*, 379 U.S. 594, 611 (1965). Prior to the enactment of the current Bankruptcy Code, the phrase already "had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations." *Case*, 308 U.S. at 115. Congress clearly knew that the meaning included the new value principle, yet evinced no indication to change it. Accordingly, this Court should presume that Congress intended the Bankruptcy Code to incorporate all aspects of pre-Code "fair and equitable" jurisprudence, including the ability of existing equity holders to contribute new value in exchange for equity in the reorganized debtor.

b. The Legislative History Of The Code Manifests No Intent To Eliminate The New Value Principle.

"[T]here is nothing in the legislative history of the 1978 Code or in the language of section 1129(b)(2) suggesting that Congress intended to modify past judicial interpretation of the absolute priority doctrine or its new

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developed pre-Code principle in two court of appeals decisions and one bankruptcy court decision. No decision of the Court was cited as proof that the pre-Code principle existed. *See* 474 U.S. at 500-01; *see also* 474 U.S. at 512 (Rehnquist, J., dissenting). The prior statements of this Court regarding the new value principle provide a far more compelling basis for finding an established pre-Code practice than existed in *Midlantic*.

value [corollary]." *In re SLC Ltd., V,* 137 B.R. 847, 853 (Bankr. D. Utah 1992) (citations omitted). Indeed, the *only* reference to the new value principle found in the legislative history consists of a proposal to *relax* the principle's requirements and make new value plans *easier* to confirm, which Congress rejected. Early in the legislative process, the Bankruptcy Commission proposed to broaden the principle in order to permit contributions of value other than "money or money's worth" to suffice as new value. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., pt. I, 258-59; Pt. II, §§ 7-303(4) & (7), 7-310 (1973). Congress rejected that proposal, thereby evincing an intent not to *dilute* the established requirements of the new value principle. Even though Congress' attention was thus clearly drawn to the new value principle,[10] Congress took no action to narrow or limit its availability. *See In re Snyder*, 967 F.2d at 1129-30.[11]

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[10] The House Committee on the Judiciary prepared a chart comparing the Commission's proposal to prior law and noted that "[t]his 'future contribution' doctrine sharply departs from the absolute priority rule of § 221(2) of the Bankruptcy Act. The Supreme Court decision in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), is overruled." Hearings on H.R. 31 & 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary, 94th Cong., 1st & 2d Sess., Ser. 27, App. 248 (1975) (relevant portions set forth in Appendix hereto).

[11] Ironically, some critics of the new value principle claim to derive support from Congress' rejection of the Bankruptcy Commission's proposal to dilute that principle. *See Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361-62 (7th Cir. 1990). This seems to be an odd use of legislative history; the fact that a diluted version of a principle is rejected does not indicate Congressional intent to reject the principle itself, especially where, as here, Congress' attention was drawn to the principle, and Congress did nothing to eliminate it.

c. The Absence Of An Express New Value "Exception" In Section 1129(b) Of The Code Does Not Diminish The Vitality Of The New Value Principle.

The Bank argues that, because section 1129(b) does not include a statutory new value "exception" to the absolute priority rule, that "exception" did not survive the enactment of the Bankruptcy Code. *See* Petr. Br. at 18. The flaw in this search for a statutory new value "exception" is self evident; properly understood, the new value principle is not an exception at all, but is simply a corollary to the absolute priority rule. *See In re Snyder*, 967 F.2d at 1130. The receipt or retention of equity in the reorganized debtor by existing owners, in exchange for a new contribution of money or money's worth that is reasonably equivalent in value to the equity received or retained, simply does not violate the absolute priority rule in the first instance. Just as a plan could provide for the sale of equity in the reorganized debtor to a third party for fair consideration, the current owners, by paying that amount, may purchase or retain an equity interest. *In re Shepcaro*, 144 B.R. 3, 4 (Bankr. D. Mass. 1992).

Whatever the genesis of the phrase "new value exception," it cannot be traced to *Case* and the other pre-Code cases that addressed the new value principle. Those cases did not speak of an "exception" to the absolute priority rule, but rather addressed the circumstances under which the receipt of new equity in exchange for a new capital contribution would not violate that rule in the first instance.[12]

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[12] The first reference to a new value "exception" in any decision of this Court appeared ten years after the enactment of the Code, in *Ahlers*, 485 U.S. at 203-06. In *Ahlers*, however, the issue whether the new value principle was an "exception" to the

d. The Fact That The "Fair And Equitable" Requirement Now Applies To Dissenting Classes, Rather Than To Dissenting Creditors, Does Not Abrogate The Pre-Code Interpretation Of That Requirement.

The Bank argues that the new value principle did not survive the Bankruptcy Code's enactment because, according to the Bank, the Code altered the meaning of the phrase "fair and equitable." Petr. Br. at 37-38. Under Chapter X of the former Bankruptcy Act, a plan of reorganization could be confirmed only if it was "fair and equitable" for *each* dissenting creditor. *See* Bankruptcy Act § 221, former 11 U.S.C. § 621. Thus, under the prior law, the "fair and equitable" requirement applied even to a class that accepted the plan. Under Bankruptcy Code section 1129(b)(1), however, the "fair and equitable" requirement applies only where a class of claims rejects the plan and is not implicated where a class accepts the plan but contains dissenting creditors. Thus, the Bank argues, the application of the new value "exception" to the absolute priority rule against members of a rejecting class was not addressed in cases decided under the Bankruptcy Act.

The basic flaw in this theory is that, in specifying the requirements applicable to a dissenting class, Congress chose to use a phrase – "fair and equitable" – which the Court long ago referred to as "words of art which. . . . had acquired a fixed meaning." *Case*, 308 U.S. at 115. There is nothing in the legislative history of the Code that

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absolute priority rule was not the subject of any argument. The debtors themselves contended that their plan fell within an "exception" to the absolute priority rule, and no one challenged this characterization. *See id.* at 201-02 & n.2. Thus, the Court in *Ahlers* had no occasion to decide whether that characterization of the new value principle was accurate.

indicates that, in using this "term of art", Congress intended to change its settled meaning because it was being applied to a nonaccepting class, rather than to a nonaccepting creditor.

"[T]he settled rule [is] that, where provisions of a statute had previous to their re-enactment a settled significance, that meaning will continue to attach to them in the absence of plain implication to the contrary." *Heald v. District of Columbia*, 254 U.S. 20, 23 (1920); *see also Lorillard v. Pons*, 434 U.S. 575, 582 (1978) (where "Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute"). Under this settled principle, the established meaning of the "fair and equitable" requirement would not change on the basis that it now applies to a dissenting class, rather than to a dissenting creditor.

C. The Fact That A Plan Provides For Existing Equity Holders Alone To Make The New Capital Contribution If The Plan Is Confirmed Does Not Result In The Receipt Of Any Property "On Account Of" An Existing Equity Interest In The Debtor.

Faced with (1) the fact that nothing in the plain language of section 1129(b)(2)(B)(ii) prevents a "new value" plan from satisfying the "fair and equitable" requirement, (2) the existence of the "new value" principle under pre-Code case law, and (3) the absence of any indication that Congress intended to abrogate that principle, the Bank focuses its challenge on the "exclusive opportunity" to buy new equity of the reorganized debtor which LaSalle's plan assertedly gave to existing equity holders. This challenge is predicated on the novel theory that a plan that gives existing equity holders alone the

opportunity to make a new capital contribution in exchange for an equity interest in the reorganized debtor gives such holders "property" on account of their junior equity interests. That "property", the argument goes, is not the equity in the reorganized debtor (which is paid for by the new contribution), but the so-called "exclusive right" to buy the new equity.

The Bank's argument ignores the fact that, under the plain terms of LaSalle's plan (like most new value plans), equity holders did not receive an *option* to obtain equity. Rather, for the plan to become effective, equity holders were *required* to contribute the requisite new value. *See* Joint App. at 37 (the "partners *shall* make, or cause to be made, the capital contributions to the Reorganized Debtor") (emphasis added). When the plan took effect, the only "property" that the existing equity holders received was the new equity interests obtained on account of their new value contributions.

Although section 1129(b)(2)(B)(ii) prohibits existing equity holders from receiving property on account of their existing junior interests, nothing in that statute or otherwise in the Bankruptcy Code prohibits equity holders from proposing or supporting a plan that requires their participation in the debtor's reorganization on account of something other than their existing equity, such as a new value contribution. To the contrary, the Code makes clear that equity security holders have the same right to propose, negotiate, object to, or support reorganization plans as do creditors. *See, e.g.*, 11 U.S.C. § 1121(c).[13]

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[13] Even during the period of plan exclusivity, the exclusive right to file a plan is a right that belongs to the *debtor* under the Code, and not to the debtor's equity holders. *See* 11 U.S.C. § 1121(a). This distinction is sharpened in many chapter 11 cases where the debtor is a publicly traded corporation.

Moreover, even if the Bank were correct that the existing equity holders' new value contribution was in fact an "option", the exclusivity of that so-called option in no way affected whether it was "property" distributed on account of existing equity interests. The "property" LaSalle's existing equity holders received was in exchange for their new value contribution, which the Bankruptcy Court determined was necessary and a fair equivalent of the equity received. The nature of the property they received would have been no different were creditors to have contributed new value for shares of new equity as well.

Because there exists no principled distinction between a new value plan under which only existing equity holders contribute new value and one under which creditors may make new value contributions as well, the only logical conclusion of the Bank's argument is that existing equity can *never* receive or retain any consideration under a new value plan. Yet, as set forth above, *see* 8-20 *supra*, the plain statutory language, legislative history, and pre-Code practice all preclude such a *per se* prohibition on equity holders receiving or retaining consideration under such a plan.

Bankruptcy Code section 1129(a)(11) *requires* that a plan be feasible in order to be confirmed. Thus, any plan that provides for the purchase of equity in the reorganized debtor in exchange for new capital must identify the source that will provide the new capital; otherwise, the plan would be built on thin air. A plan that identifies existing equity holders as the source of the new capital is no more objectionable than one that identifies creditors (or even a third party) as the source of the new capital. In either event, the plan does not allow any party to receive equity in the reorganized debtor on account of an existing

interest in the debtor, but rather only on account of a payment of new, necessary capital.

D. Policy Considerations Favor The Continued Vitality Of The New Value Principle.

In light of the plain statutory language and the ample pre-Code precedent recognizing the "new value" principle, it should be unnecessary to delve into the policy considerations that favor or disfavor the new value principle. To the extent that such policy considerations are relevant, however, they support reaffirmation of the new value principle.

This Court consistently has recognized "the congressional goal of encouraging reorganization." *Bildisco*, 465 U.S. at 527; *Whiting Pools*, 462 U.S. at 204. In pursuit of this goal, an infusion of new capital may be required for a successful reorganization. As a practical matter, the holders of existing equity may be the only realistic source of such new capital, especially in the case of a small or medium sized business that is financially troubled. Owners may have greater confidence than outsiders in the viability and future of a troubled business. They may have nonmonetary reasons to provide new value (such as having spent years building up a business or a real estate project) that would not be shared by others. There is no reason to deprive the reorganization process of what may be the most likely source of new capital, by adopting a *per se* rule that prohibits existing investors from buying back into the debtor in exchange for a fair and necessary capital infusion, whenever one class of creditors (which may consist of a single creditor such as the Bank) refuses to accept a plan that the majority of other creditors support.

The Bank contends that the new value principle is unnecessary because creditors supposedly will consent to

infusions of new value when it is in the best interests of the debtor's creditors and estate. Pet. Br. at 47. This contention ignores the possibility that a single class of creditors, or as here a single dissenting creditor, often may have its own agenda that does not include the reorganization of the debtor, even when reorganization is in the best interests of every other creditor constituency. *Cf. In re Snyder*, 967 F.2d at 1130 ("there are many reasons why creditors (often a single controlling creditor) withhold consent", citing example of a competitor of the debtor); *In re U.S. Truck Co.*, 800 F.2d 581, 587 (6th Cir. 1986) (recognizing that a union might vote to reject a plan "not because the plan is less than optimal to it as a creditor, but because the [union] has a noncreditor interest – *e.g.*, rejection will benefit its members in the ongoing employment relationship").

In this case, the Bank's real economic interest lies with respect to the plan's treatment of its *secured* claim, which treatment the lower courts unanimously found was fair and equitable because the plan pays the claim in full with interest. Yet, what is at issue here is the treatment of the Bank's *unsecured* deficiency claim – which nonrecourse claim would have been worthless were the Bank allowed to foreclose. By challenging the plan on the basis of its *unsecured* claim, the Bank is really attempting to leverage even better treatment for its own *secured* claim to the detriment of *all* of LaSalle's other unsecured creditors who support the plan and who will receive nothing if the Bank is allowed to foreclose.

There is of course nothing wrong with a creditor such as the Bank voting against confirmation of a plan to promote its own self interests. It is precisely because creditors do look out for their own self interests, however, that the Bankruptcy Code compels confirmation of a fair and equitable plan which otherwise satisfies the rigid

requirements of section 1129 notwithstanding the rejection of the plan by one or more classes of creditors.

Similarly, the Bank fails to address the phenomenon of cases involving numerous classes of creditors, where there is no value for a junior class of creditors under a new value plan or otherwise. Under the Bank's theory, a junior class of creditors for which there is no value (such as the holders of subordinated debt) could veto a "new value" plan, even if that plan was accepted by, and would be in the best interests of, the senior creditor classes. That is precisely the scenario that one court avoided by applying the new value principle. *See In re Resorts Int'l, Inc.*, 145 B.R. 412 (Bankr. D.N.J. 1990).[14]

The Bank contends that the new value principle enables old equity holders to repurchase an interest in the debtor at a bargain price, thereby diverting value within an insolvent estate from creditors to equity holders. The appropriate answer to this criticism is not the abrogation of the new value principle, but rather vigilance on the part of courts in requiring that the proponent of the plan affirmatively demonstrate compliance with each of the

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[14] The plan in *Resorts* was premised on the infusion of over $20 million in new and necessary operating capital by the existing equity holder in exchange for 21.5 percent ownership of the reorganized debtor. *Id.* at 434-35, 484. Creditor classes holding over $900 million in claims in the aggregate accepted the plan by overwhelming majorities. See *id.* at 429-31, 433. However, junior classes, consisting of disputed, securities-related litigation claims and other subordinated claims, rejected the plan. *See id.* at 430-31, 481. There was no value in the estate for these junior classes of claims, and the plan provided no distribution to these classes. *See id.* at 432, 478, 481-82. Under the Bank's theory, these junior, "out-of-the-money" classes could have vetoed the "new value" plan in *Resorts* unless they received "hold up" value. There is no principled bankruptcy policy that would support such a veto power.

requirements of that principle. First, the requirement that the contribution be in money or money's worth ensures that the contribution is actually of tangible value. Second, the requirement that the contribution be substantial and necessary means that the capital contribution must in fact promote the rehabilitative purposes of the Code – a purpose that is not served by small, unnecessary contributions. *See In re Snyder*, 967 F.2d at 1131. Third, the requirement that the new capital contribution must provide fair value for the equity interest that is received or retained prevents value from being unfairly diverted from the estate to the investor. *See In re Woodscape Ltd. Partnership*, 134 B.R. 165, 177 (Bankr. D. Md. 1991) (creditors must receive enterprise values that exist at confirmation determined before new investment is made).[15]

Finally, the Bank contends that the new value principle somehow reduces recoveries to creditors from the bankruptcy estate. The facts of this case belie the Bank's assertion. As noted, the courts below found that existing equity holders paid a fair price for the equity they purchased through their new value contribution under the plan. Solely because of the equity holders' new value contribution, LaSalle's plan was able to provide for the payment of the Bank's secured claim and all of the

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[15] The real protection afforded to creditors by these requirements is highlighted by the fact that courts have not hesitated to deny confirmation of plans that did not satisfy the requirements of the new value principle. *See, e.g., Carson Nugget, Inc. v. Green (In re Green)*, 98 B.R. 981, 982 (Bankr. 9th Cir. 1989); *In re Dowden*, 143 B.R. 388 (Bankr. W.D. La. 1989); *In re Tallahassee Assocs., L.P.*, 132 B.R. 712, 718 (Bankr. W.D. Pa. 1991); *In re Mortgage Inv. Co.*, 111 B.R. 604, 618-20 (Bankr. W.D. Tex. 1990); *In re Yasparro*, 100 B.R. 91, 98 (Bankr. M.D. Fla. 1989); *In re 47th and Belleview Partners*, 95 B.R. 117, 119 (Bankr. W.D. Mo. 1988); *In re Sawmill Hydraulics, Inc.*, 72 B.R. 454, 458 (Bankr. C.D. Ill. 1987).

estate's general unsecured creditors in full. The *only* unsatisfied creditors' claims were those of LaSalle's insiders (which were voluntarily waived) and the Bank's unsecured deficiency claim (for which the Bank would have received nothing were it allowed to foreclose). Application of the new value principle in this case thus enhanced recoveries to most of LaSalle's creditors, who would have received nothing in the event of the Bank's foreclosure, without in any way diminishing the Bank's recovery from the estate. For this reason, *amici curiae* strongly support the decision of the Court of Appeals below.

IV.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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August 17, 1998

APPENDIX

BANKRUPTCY ACT REVISION

HEARINGS
BEFORE THE
SUBCOMMITTEE ON CIVIL
AND CONSTITUTIONAL RIGHTS
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
NINETY-FOURTH CONGRESS
FIRST AND SECOND SESSIONS
ON
H.R. 31 and H.R. 32
BANKRUPTCY ACT REVISION

Appendix

Serial No. 27

H.R. 31

SEC. 7-303. PROVISIONS OF PLAN. – A plan of reorganization –

* * *

(4) may provide, if the court finds that, (A) in the case of a partnership debtor, when the partners retain an interest under the plan, (B) in the case of an individual, when he retains an interest under the plan, and (C) in the case of a corporate debtor, when the equity security holders retain an interest under the plan, the individual debtor, certain partners or equity security holders will make a contribution which is important to the operation of the reorganized debtor or the successor under the plan, for participation by the individual debtor, such partners, or such holders under the plan on a basis which reasonably approximates the value, if any, of their interests, and the additional estimated value of such contribution;

H.R. 32

PART 3. PROVISIONS RELATING TO PLAN

SEC. 7-301. PROVISIONS OF PLAN. – A plan of reorganization –

* * *

(4) may provide for equity security holders to retain an interest under the plan, if the court finds the equity security holders will make a contribution which is important to the operation of the reorganized debtor or the successor under the plan, for participation by such holders under the plan on a basis which reasonably approximates the value, if any, of their interests, and the additional estimated value of such contribution;

COMMENTS

H.R. 32 allows participation by equity security holders who will make important future contributions. H.R. 31 adds partners of a debtor and an individual debtor. This "future contribution" doctrine sharply departs from the absolute priority rule of § 221(2) of the Bankruptcy Act. The Supreme Court decision in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) is overruled. The proposed law follows the district court opinion in that case.

Supreme Court, U.S.
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(16)

No. 97-1418

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF OF BRUCE A. MARKELL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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TABLE OF CONTENTS

Page

Table of Contents i

Table of Authorities iii

Interest of *Amicus Curiae* 1

Summary of Argument 2

Argument 4

I. Section 1129(b)(1)'s Requirement That a Non-Consensual Plans Be "Fair and Equitable" Governs This Case 4

II. Through the Use of the Words "Fair and Equitable," Congress Captured a Concept With a Well-Known Meaning in Reorganization Practice 7

A. *The Judicial and Statutory Origins of "Fair and Equitable"* 8

1. The First Codification -- Sections 77 and 77B 9

2. The Meaning of the First Codification: *Case v. Los Angeles Lumber Prods. Co.* 10

3. The Second Codification -- The Chandler Act of 1938 12

4. The Preservation of New Value Principles After *Case* 13

5. The Third Codification -- The Bankruptcy Reform Act of 1978 15

B. *Congress' Use of "Fair and Equitable" Incorporated Into Section 1129(b)(1) a Dynamic Rule That Covers Far More Than Section 1129(b)(2)'s Examples* 21

1. The Uncodified Components 21

Page

2. Cases of Literal Compliance with Section 1129(b)(2) That Nonetheless Are Not "Fair and Equitable" 22

III. **New Value Concepts Are Part of the Logic and Policy of the "Fair and Equitable" Rule** 22

A. New Value is Logically Identical to Absolute Priority 23

B. New Value Concepts Are Essential to Reorganization Policy 25

Conclusion 27

TABLE OF AUTHORITIES

Cases **Page[s]**

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11 U.S.C. § 1111(b)(1)(A) 5

11 U.S.C. § 1121 15

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Page[s]

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Chapter X, Bankruptcy Act of 1898 (repealed 1979) 13-15

Chapter XI, Bankruptcy Act of 1898 (repealed 1979) 13-15

Chapter XII, Bankruptcy Act of 1898 (repealed 1979) 13-14

Legislative Materials

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Page[s]

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COLLIER ON BANKRUPTCY ¶ 1129.04[4][a][ii] (15th ed. rev. 1998) 21

COLLIER ON BANKRUPTCY ¶ 1129.04[4][b][i] (15th ed. rev. 1998) 22

COLLIER ON BANKRUPTCY ¶ 1129.04[4][b][ii] (15th ed. rev. 1998) 22

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SECURITIES AND EXCHANGE COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, *Part VIII* (A Summary of the Law Pertaining to Equity and Bankruptcy Reorganizations and of the Commission's Conclusions and Recommendations) (1940) 6, 9

Supreme Court Rule 37.3(a) 1

Page[s]

Robert T. Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 COLUM. L. REV. 901 (1927) 11

J. Ronald Trost, *Corporate Bankruptcy Reorganization: For The Benefit of Creditors or Shareholders?*, 21 U.C.L.A. L. REV. 540 (1973) 17

No. 97-1418

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF OF BRUCE A. MARKELL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF *AMICUS CURIAE*[*]

In accordance with Rule 37.3(a) of this Court's rules, the undersigned respectfully submits his pro se *amicus curiae* brief in support of Respondent. Both parties have consented to the filing of this brief, and their written consents are on file with the Clerk of the Court.

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[*] In accordance with Supreme Court Rule 37.6, the undersigned *amicus curiae* represents that no party other than himself authored this brief, or any part of it, and that no other person or entity has made a monetary contribution to any aspect of this brief's preparation or submission, including its printing.

Amicus is a law professor and student of bankruptcy law. He has written articles on the issue presented in this case, and is the principal author of chapters 1111 and 1129 in COLLIER ON BANKRUPTCY (15th rev. ed. 1998). He represents no institution, group or association, and as with those academic *amici* supporting Petitioner, submits this brief to offer what assistance he can on this critical issue in bankruptcy reorganization practice.

SUMMARY OF ARGUMENT

1. Section 1129(b)(1) of the Bankruptcy Code[1] governs this case. It allows courts, under specified conditions, to confirm plans of reorganization in bankruptcy which have the support of some, but not all, of the debtor's creditors. One of these conditions is that such a plan must be "fair and equitable" as to any dissenting class of creditors. The Bankruptcy Code does not, however, define the exact scope of "fair and equitable." Rather, Congress provided, in Section 1129(b)(2), non-exclusive examples of compliance with the "fair and equitable" rule. Section 1129(b)(2)(B)(ii), the example at issue in this case, states that a plan is not "fair and equitable" when the holder of a junior interest receives or retains anything under the plan "on account of" that holder's pre-bankruptcy interest.

To ensure a reading of Section 1129(b)(2)(B)(ii) that does not render the phrase "on account of" superfluous, courts must be able to confirm plans of reorganization over the dissent of a class when junior interests receive some interest under a plan of reorganization. Otherwise, Congress could have dropped the words "on account of," with the result that Section 1129(b)(2)(B)(ii) would bar equity holders and other

[1] In this brief, all reference to the "Bankruptcy Code" or simply the "Code" are references to title 11 of the United States Code which codifies federal bankruptcy law. Similarly, references to "Section xxxx" are references to that section in title 11 of the United States Code.

junior interests from ever receiving any interest under a plan of reorganization.

The circumstances under which equity holders can continue their ownership in a bankruptcy debtor -- that is, the circumstances when receiving an interest are *not* "on account of" their prior interest -- are provided by the history and purpose of the "fair and equitable" requirement. That such history is relevant is shown by Congress' decision to incorporate, in Section 1129(b)(1), a term of art such as "fair and equitable." When Congress chooses to use a term of art in a technical statute such as the Bankruptcy Code, this Court has looked to the statutory context of the wording, and has deferred to prior judicial interpretations of that term.

2. The phrase "fair and equitable" is one of the most history-laden phrases in the Bankruptcy Code. Congress first used the phrase during the Depression to incorporate, into statutory bankruptcy law, judicial concepts originating in federal equity receiverships. These receivership practices developed during the later part of the Nineteenth Century in response to the need to reorganize, rather than liquidate, large capital-intensive business such as railroads. One of the many practices incorporated into the "fair and equitable" concept was the ability of the shareholders in an insolvent debtor to make fresh contributions of capital in return for an interest in the reorganized entity roughly worth the amount of the contribution. Indeed, the cases involving owner contributions focused not on *whether* equity owners could participate in reorganizations; rather, they focused *on what terms* such owners could participate. This Court has always indicated that such practices are part of the "fair and equitable" concept, and there is no reason to reject those cases here.

3. Finally, that this reading of Section 1129(b)(1) is correct is confirmed by the logic and policy of corporate reorganizations generally. As a matter of logic, the formulations of standards for the application of the "fair and equitable" rule can be mathmatically reformulated to show that owner participation, on the same terms as participation by

independent third parties, is a logical and integral part of "fair and equitable." As to policy, the Bankruptcy Code seeks to preserve viable businesses for all stakeholders, be they creditors, owners or the communities in which the businesses are located. Allowing equity holders to participate in the reorganization process on the same basis as other potential buyers of the debtor furthers this goal by increasing the pool of those interested in buying the post-confirmation debtor. This increased pool, in turn, leads to higher bids or contributions to the debtor, with concomitant higher returns to all stakeholders.

ARGUMENT

I. Section 1129(b)(1)'s Requirement That a Non-Consensual Plans Be "Fair and Equitable" Governs This Case

Chapter 11 of the Bankruptcy Code expressly permits confirmation of chapter 11 plans of reorganization[2] without the unanimous consent of all classes of creditors. In Section 1129(b)(1) of the Code, Congress provided express conditions for confirmation: all requirements for a consensual plan set for in Section 1129(a) (except for consent) must be met and, in addition, the plan must be "fair and equitable, with respect to each" dissenting class. 11 U.S.C. § 1129(b)(1).

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[2] A chapter 11 plan of reorganization is a document prepared by the parties which specifies both the method and manner of satisfaction of creditor claims and the proposed structure of the debtor after reorganization. Individuals, called "plan proponents," may propose such plan, which are summarized and distributed to creditors and equity holders. If all other requirements are met -- including a requirement that the reorganization will not likely be followed by the need for further reorganization, 11 U.S.C. § 1129(a)(11) -- then the bankruptcy judge "confirms" the plan by entering an order giving the plan effect. The confirmation order affects all creditors and equity security holders of the debtor, regardless of how they voted on the plan, 11 U.S.C. § 1141(d). A confirmed plan has the effect of a grand novation of all of the debtor's obligations. *See generally* COLLIER ON BANKRUPTCY ¶ 1129.01[1] (15th rev. ed. 1998).

In this case Respondent, 203 North LaSalle Street Limited Partnership ("Debtor"), confirmed a plan of reorganization in its chapter 11 bankruptcy case without the consent of Petitioner, Bank of America, NT&SA ("Bank"). Debtor, as the plan proponent, bore the burden of establishing that its plan met all of Section 1129(a)'s requirements, other than voting, and was "fair and equitable" as to the Bank. The bankruptcy court found that the Debtor had met this burden, and the district court and the Seventh Circuit panel affirmed. In this Court, the Bank claims that the plan was not "fair and equitable" as to its unsecured deficiency claim, a claim that is non-existent under state law, and exists only in chapter 11 as a matter of federal law.[3]

Whether a plan is "fair and equitable," however, is a question with long historical antecedents. To reflect and simplify the application of that history, Congress added Section 1129(b)(2) which gives a non-exclusive list of examples of "fair and equitable" treatment. The dissent below, and the Bank and the *amici* here, focus primarily on a clause contained in a sub-paragraph of Section 1129(b)(2) in concluding that the Debtor's plan could not be confirmed.

That argument is wrong as a matter of statutory construction. As Debtor's brief in this Court shows, the language of Section 1129(b)(2)(B)(ii) does not bear the weight of construction placed on it by the Bank. It either

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[3] Under the Bankruptcy Code, the Bank has two claims: a secured claim equal to the value of its collateral, and an unsecured claim equal to the deficiency between the total obligation owed and the value of the collateral. 11 U.S.C. § 506(a). The plan here fully satisfied the secured claim, leaving only the unsecured deficiency claim. The Bank, however, made its loan on a non-recourse basis; that is, it agreed not to look to the debtor for any remaining claim owed after the Bank foreclosed its mortgage. Although such arrangements are respected in chapter 7 liquidations, in chapter 11 reorganizations the Code gives non-recourse lenders such as the Bank enhanced protection by recognizing, notwithstanding contrary non-bankruptcy law, the claim which would remain after foreclosure. 11 U.S.C. § 1111(b)(1)(A). *See generally* COLLIER ON BANKRUPTCY, *supra*, at ¶ 1111.03.

misconstrues the type of causation anticipated by Section 1129(b)(2)(B)(ii)'s "on account of" language, or it reads that language out of the statute altogether.

It is no accident that Congress included the "on account of" language in Section 1129(b)(2)(B)(ii). Its placement there serves to amplify that no equity holder can, without more, retain its interest in the debtor if any dissenting class of creditors is unpaid. But if the equity holder does more -- if in the terms of the statute its receipt of an interest in the post-confirmation debtor is *not* "on account of" its pre-petition interest -- then Section 1129(b)(2)(B)(ii) does not apply. The question then becomes whether the general rule, found in Section 1129(b)(1), permits equity holders to make contributions and receive interests tailored to the consideration paid for those interests. Put another way, the issue is whether Section 1129(b)(1)'s requirement that a plan be "fair and equitable" as to dissenting classes prohibits such a plan.

It is manifest that a simple reading of the simple phrase "fair and equitable" does not answer this question. It was not intended to. The term "fair and equitable" is a term of art rich in history and meaning, and has been so for over 50 years. SECURITIES AND EXCHANGE COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, *Part VIII* (A Summary of the Law Pertaining to Equity and Bankruptcy Reorganizations and of the Commission's Conclusions and Recommendations), at 142 (1940) [hereinafter cited as "SEC REPORT"].

When Congress uses terms of art such as "fair and equitable" in a statute, as this Court recently stated, "it is a 'fundamental principle of statutory construction (and, indeed, of language itself) that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used.'" *Textron Lycoming Reciprocating Engine Division v. United Automobile, Aerospace & Agricultural Implement Workers*, 118 S. Ct. 1626, 1629 (1998), *quoting Deal v. United States*, 508 U.S. 129, 132

(1993). As Chief Judge Posner has recently added when interpreting the Bankruptcy Code, "[t]he context consists not merely of other sentences but also of the real-world situation to which the language pertains. . . . When context is disregarded, silliness results." In re *Handy Andy Home Improvement Centers, Inc.*, 144 F.3d 1125, 1128 (7th Cir.1998).

The "real-world situation" applicable in this case is the confirmation of a plan of reorganization, and over a hundred years of jurisprudence as to what is fair and equitable. In such cases this Court has recognized that "[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." *Midlantic Nat'l Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986) (citation omitted). *See also Dewsnup v. Timm*, 502 U.S. 410, 419-20 (1992). That the wording Congress chose in Section 1129(b)(1) simply carried over pre-Code practice -- a practice that included new value principles -- is shown by the phrase's history and use in corporate reorganizations.

II. Through the Use of the Words "Fair and Equitable," Congress Captured a Concept With a Well-Known Meaning in Reorganization Practice

Congress did not pick the words "fair and equitable" out of thin air when it adopted Section 1129(b)(1) in 1978. Rather, Congress borrowed the phrase from prior bankruptcy enactments, which in turn were attempts to codify then-existing judicial practice. In short, when Congress chose the term "fair and equitable" as the test for non-consensual plans of reorganization, it was writing against over forty years of statutory history and over a century of reorganization practice.

A. *The Judicial and Statutory Origins of "Fair and Equitable"*

In large part, the history of corporate reorganizations is the history of railroad reorganization. Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 74-83 (1991) [hereinafter cited as "*Owners, Auctions*"]. Prior to 1933, however, railroad reorganizations were handled in federal equity receiverships; railroads were not eligible to be bankrupts under the Bankruptcy Act of 1898. Such receiverships were often necessary. By 1915 over one-half of all railroad debt securities had been in default at one time or another. WILLIAM Z. RIPLEY, RAILROADS: FINANCE & ORGANIZATION 374 (1915).[4]

The funds used to reorganize these companies typically came from existing shareholders. Necessity dictated this trend. Equity holders were thought to be the most likely source. *See* 2 ARTHUR STONE DEWING, THE FINANCIAL POLICY OF CORPORATIONS 1327-33 (4th ed. 1941). Indeed, this Court and others had many occasions to pass on the propriety of continued owner participation in equity receiverships. *See, e.g., Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445 (1926); *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482 (1913); *Louisville Trust Co. v. Louisville, N.A. & C. Ry.*, 174 U.S. 674 (1899); *Chicago Rock Island & Pac. R.R. v. Howard*, 74 U.S. (7 Wall.) 392 (1868); *Jameson v. Guaranty Trust Co.*, 20 F.2d 808 (7th Cir. 1927); and *Oehring v. Fox Typewriter Co.*, 272 F. 833 (6th Cir. 1921).

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[4] Writers during this time seemed to embrace a fairly constant estimate that, at any given time, about one in seven railroads were in receivership. *See, e.g.*, Paul D. Cravath, *Reorganization of Corporations*, in 1 SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 153, 154 (1917); John Franklin Crowell, *Railway Receiverships in the United States*, 7 YALE REV. 319, 319 (1898).

1. The First Codification -- Sections 77 and 77B

All of this changed during the Depression. In 1933, Congress added Section 77 to the 1898 Bankruptcy Act. Act of March 3, 1933, ch. 204, 47 Stat. 1467. Not only did this section change prior law by permitting railroads to be bankrupts, it also codified and incorporated existing receivership practices.

One such practice was the drafting and approval of plans of reorganization which stated the revised capital structure of the reorganized entity, and which also provided for distributions to creditors. *Owners, Auctions*, *supra* at 74-77. To confirm a plan, Section 77 followed equity practice and required that the plan be "fair." Act of March 3, 1933, ch. 204, § 77(g), 47 Stat. 1467, 1479. *See* SEC REPORT, *supra* at 142 ("Since these words [fair and equitable] were not defined in the statutes, it was to be expected that their meaning would be derived from the background of equity reorganization practice.").

A year later, when extending bankruptcy relief to municipalities, Congress used, for the first time, the full phrase "fair and equitable." Using Section 77 as a template for municipal reorganization, Congress added the words "and equitable" to "fair" in the provisions related to confirmation of plans. Act of May 24, 1934, ch. 345, § 80(e), 48 Stat. 798. Shortly thereafter, Congress again used this revised language of "fair and equitable" when enacting Section 77B, which extended bankruptcy reorganization relief to corporations generally. Act of June 7, 1934, ch. 424, § 77B, 48 Stat. 911, 912.[5]

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[5] Until the Depression, reorganization relief was not generally available under statutory bankruptcy law. A business could liquidate under chapter VII of the 1898 Bankruptcy Act, or try to effect a composition with its unsecured creditors under that Act. Although helpful in some situations, these provisions proved inadequate to allow broad-based reorganizations of large and small companies. Federal equity practice came to provide these types of powers, and thus the majority of

Section 77B's confirmation requirements thus mirrored the municipal reorganization act: it required that, to be confirmed, plans had to be "fair and equitable." *Id.* § 77B(f)(1). A year later, in 1935, Congress amended the railroad reorganization provision -- Section 77 -- to conform to this formulation. Act of Aug. 27, 1935, ch. 774, § 77(e)(1), 49 Stat. 911, 918.

2. The Meaning of the First Codification: *Case v. Los Angeles Lumber Prods. Co.*

Against this background, this Court heard *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939). In *Case*, the debtor had filed under new Section 77B of the 1898 Bankruptcy Act. Using Section 77B's provision which allowed the debtor to retain possession of its assets, the debtor continued to operate and propose a plan. Under this plan, existing shareholders retained 23% of the equity for no additional monetary consideration. Bondholders, such as the petitioner Thomas Case, were to receive the remainder, plus certain preferred shares.

The question presented was whether the plan was "fair and equitable" within the meaning of Section 77B(f)(1). This Court, speaking through Justice William O. Douglas, stated the "words 'fair and equitable' . . . are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations." 308 U.S. at 115. In essence, Justice Douglas used the congressional phrase "fair and equitable" as a lens through which to view and carry forward the practices and precedents of equity receiverships. He confirmed this reading by citing pre-1933 precedents of this Court and other lower courts as determinative of the content of the phrase "fair and equitable." *Id.* at 116-120 (*quoting*

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what we would call "reorganizations" today were carried out in federal equity courts before the 1930s. The history of receivership practice is recounted in *Owners, Auctions, supra* at 74-83.

Chicago Rock Island & Pac. R.R. v. Howard, 74 U.S. (7 Wall.) 392 (1868); *Louisville Trust Co. v. Louisville, N.A. & C. Ry.*, 174 U.S. 674 (1899); *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482 (1913); and *Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445 (1926)).

Chief among the components of "fair and equitable" that Justice Douglas examined was the so-called absolute priority rule. At issue in *Case* was the view that the term "fair and equitable" permitted plans that preserved "relative priority;" that is, that preserved claims to future income based on current entitlements without the necessity of first paying senior claims in full. The proposed stock issuance, together with certain dividend restrictions on the stock issued, preserved relative priorities.[6] *Case*, 308 U.S. at 119-20. Under the absolute priority standard, the plan failed miserably. The debtor's principal assets were worth some $830,000, and there was a first mortgage outstanding of more than $3,800,000. *Id.*

Thus, *Case* could have been decided solely on absolute priority grounds. The value of the debtor's property did not permit continued participation by its shareholders. Although the debtor's main arguments concerned the relative priority standard, it also attempted to show that even absolute priority would permit continued shareholder participation. It argued that its shareholders were contributing sufficient value to retain their interests through their "continuity of management" and "financial standing and influence in the community." *Id.* at 122.

Justice Douglas did not dismiss this argument out of hand, as would Bank in this case. Instead, Justice Douglas recognized that old equity owners could participate, but only

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[6] Under relative priority, the value of the securities issued to such shareholders often *exceeded* the amount contributed by the shareholders. *See* A.S. DEWING, *supra*, at 1395; Robert T. Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 COLUM. L. REV. 901, 914-15 (1927).

under certain conditions. In this respect, he was following this Court's precedent. In particular, this Court had stated in *Kansas City Terminal Ry. Co. v. Central Union Trust Co. of New York*, 271 U.S. 445, 455 (1926), that "[g]enerally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them."

In *Case*, Justice Douglas gave content to this notion. In particular, he stated that "where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder." *Case*, 308 U.S. at 122.

Justice Douglas then applied only half of this test. He first looked at the proposed contributions of continuity and reputation. These were surely different from the cash asSess.ments prevalent in equity reorganizations. He categorized the claimed contributions as "intangible[]" and "ephemeral." *Id.* at 122-23. Allowing such "vague hopes or possibilities" to count as contributions, he stated, would permit "easy evasions of the principle of full or absolute priority . . .. ." *Id.* at 122.

Having disqualified the proffered consideration's quality, Justice Douglas never analyzed its quantity. As a consequence, he never directly addressed the scope and meaning of "reasonable equivalen[ce]". Had Section 77B stayed in the Act, shareholders may have had the incentive to test the limits of "reasonable equivalen[ce]."

3. The Second Codification -- The Chandler Act of 1938

As Justice Douglas knew, one year prior to *Case*, Congress had overhauled the corporate reorganization sections of the Bankruptcy Act. The Chandler Act, Act of June 22, 1938, ch. 575, 52 Stat. 840, repealed the single reorganization section, § 77B, and inserted three new chapters

in its place. Congress intended the first, Chapter X, to do the bulk of the work of reorganizing large, public companies. The second chapter, Chapter XI, continued and formalized the Bankruptcy Act's composition provisions, which were directed primarily at small, owner-managed concerns. The third chapter, Chapter XII, dealt primarily with real estate partnerships.

Each of these revisions required plans of reorganization, and each copied the wording of Sections 77, 77B and the municipal arrangement section in that each required that "the plan [be] fair and equitable . . . ." to be confirmed. *See* 11 U.S.C. § 621(2) (repealed 1979) (Chapter X standard for confirmation). In explaining this provision, the legislative history simply said: "Subsection (2) of Section 221 [codified at 11 U.S.C. § 621(2)], derived from Section 77B(f)(1), provides, as a condition to confirmation of a plan, that the judge be satisfied that it is "fair and equitable," and "feasible." S. REP. NO. 1916, 75th Cong., 3d Sess. 35-36 (1938) (Senate Report No. 1916 accompanied H.R. 8046, which was the bill ultimately enacted). *See also Analysis of H.R. 12889*, 74th Cong., 2d Sess. 78 n.2 (Comm. Print 1936).

4. The Preservation of New Value Principles After *Case*

This Court, in a series of cases in the early 1940's, quickly confirmed that *Case*'s reading of "fair and equitable" applied to the same phrase in Section 77, *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pac. R.R.*, 318 U.S. 523, 542 (1943), and in Chapter X, *Marine Harbor Prop., Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942).[7] It also held that Congress' decision to

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[7] During this period, the Court also elaborated on new value components in the unfair discrimination standard then located in the municipal arrangement statute. *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536 (1946). *See* Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227 (1998).

separate reorganization relief into three classes was to be respected. The simpler Chapter XI procedure could not be used when Chapter X was more appropriate. *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940); *see also General Stores Corp. v. Shlensky*, 350 U.S. 462 (1956).

These decisions drastically affected reorganization practice. *See* Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1, 9-15 (1995). No longer could parties use the less formal Chapter XI procedure in large cases, or when more than simple adjustment of unsecured claims was required. In Chapter X, unlike Chapter XI, the debtor would be immediately replaced by a trustee. *Id.* at 11-12. The debtor would also lose exclusivity to file a plan; in Chapter X the trustee controlled the plan process. *Id.* Finally, it also meant that the minimum percentage of creditor acceptances would have to be higher; Chapter X required consents from two-thirds of an affected class while Chapter XI only required a simple majority. *Id.*

One main consequence flowed from these cases: the opportunities for new value cases dried up. Most of the cases which could have been candidates for new value principles had the debtor still been in control were now plans sponsored by the Chapter X trustee. In these plans, the equity owners and management were treated the same as any third party who wished to bid for the company in reorganization. *See, e.g.*, In re *Polycast Corp.*, 289 F. Supp. 707 (D. Conn. 1968) (trustee contacted over forty companies to find acquisition partner before sponsoring plan with debtor's management group).

Against this background, courts never received a chance in Chapter X cases to apply the second half of Justice Douglas' formulation of new value principles. Cases under Chapter XI and XII provided no precedent since Congress had eliminated the "fair and equitable" rule from those cases in 1952. *See* Act of July 7, 1952, ch. 579, § 35, 66 Stat. 420, 433.

The precedents for owner participation recognized by Justice Douglas in *Case*, seemingly moribund under Chapter X, gained new life when the 1978 Code resurrected Section 77B's concept of the debtor in posSess.ion, 11 U.S.C. § 1101, and when Congress, in Section 1121 of the Code, carried over a limited version of Chapter XI's concept of debtor exclusivity as to plan proposal.

5. The Third Codification -- The Bankruptcy Reform Act of 1978

The 1978 law, at issue in this case, got its first real start in 1973 when the congressional-authorized Bankruptcy Commission made its report. *Bankruptcy Comm'n of the United States of America, Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. 93-137, 93d Cong., 1st Sess., Parts I-II (1973) [hereinafter cited as "*Commission Report.*"]. This report comprehensively addressed the perceived shortcomings of the 1898 Bankruptcy Act, and proposed various reforms.

Among other things, the report found fault with the absolute priority rule. But the fault found was *not* that the rule was too loose. To the contrary, the Commission found "the rigidity of the [absolute priority] rule has frequently resulted in the destruction rather than the protection of interests of public investors. . . . [These investors] are frequently eliminated from participation in a reorganization by reason of the strict application of a statute designed primarily for their protection." *Commission Report*, Part I, at 256. In response, the report suggested a relaxation of some of the harder edges of the absolute priority rule. Under the proposal, equity owners could participate "if their future contributions, e.g., continued management, [were] essential to the business." *Id.*, Part II, § 7-303(4), at 258.[8]

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[8] Section 7-303(4) was designed to "adopt[] the District Court's opinion which was reversed in *Case* . . . ." *Id.*, Part II, at 254 (Com. 9(b)).

The Commission also suggested allowing delayed participation, under which equity holders could participate only if future increased performance justified that participation. *Id.*, Part II, § 7-303(3), at 241. Finally, it sought to streamline the type and amount of valuation evidence necessary to establish compliance with the absolute priority rule. *Id.*, Part II, § 7-310(2)(B), at 252. The Commission's bill was introduced during the later days of the Seventy-third Congress, H.R. 10792, 93d Cong., 2d Sess. (1973); S. 2565, 93d Cong., 2d Sess. (1973), and reintroduced at the beginning of the Seventy-fourth, H.R. 31, 94th Cong., 1st Sess. (1975); S. 236, 94th Cong., 1st Sess. (1975).

The Commission's proposed relaxation of absolute priority contained in these bills drew immediate and harsh criticism.[9] Partly as a result of disagreement over this point, an alternative bill was proposed sponsored primarily by bankruptcy judges, H.R. 32, 94th Cong., 1st Sess. (1975); S. 235, 94th Cong., 1st Sess. (1975). Faced with two contrary bills, each supported by factions whose support was necessary to enact, the legislative process halted.

This deadlock broke in early 1976 through compromise. The compromise called for two changes to the absolute priority rule, neither of which addressed the existing ability of owners to contribute fresh capital. Under the first change, only a *class* of creditors could invoke the "fair and equitable" rule. In this respect, the compromise overruled *Case* procedurally; if outvoted, no *individual* creditor could challenge a plan on the grounds that it was not "fair and

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[9] *Hearings Before the Subcommittee on Improvements in Judicial Machinery of the Committee on the Judiciary, United States Senate, on S. 235 and S. 236*, Parts 1 and 2, 94th Cong., 1st Sess 459 (1975)(Statement of Robert J. Grimmig on Behalf of the American Bankers Association); *id.* at 654-55 (Statement of the American Life Insurance Association, represented by John J. Creedon); *id.* at 709-10, 716 (statement of Philip A. Loomis, Jr., Commissioner, Securities and Exchange Commission)("We oppose the . . . modifications of the absolute priority rule.")

equitable"; that right would now accrue only to dissenting *classes* of claims.

Second, in lieu of the absolute priority rule, individual creditors received the best interest of creditors test, now found in Section 1129(a)(7) of the Code. As a consequence, once a creditor received property under a plan equal in value to what it would receive in a chapter 7 liquidation, the Code would then allocate the surplus of going concern value over liquidation value by democratic vote within and among classes of creditors. J. Ronald Trost, *Corporate Bankruptcy Reorganization: For The Benefit of Creditors or Shareholders?*, 21 U.C.L.A. L. REV. 540, 550-51 (1973).

The terms of this compromise were then set out in a letter to Congress from the respective heads of the National Bankruptcy Conference and of the National Conference of Bankruptcy Judges. The letter is reprinted in the legislative history. June 12, 1976 Letter from John Copenhaver, President, National Conference of Bankruptcy Judges and Charles A. Horsky, Chairman, National Bankruptcy Conference, *reprinted in Hearings Before the Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary, House of Representatives on H.R. 31 and H.R. 32, Bankruptcy Act Revision*, Part 3, 94th Cong., 1st & 2d Sess. 1938 (1976).

That letter explained that the compromise obviated the need to debate the Commission's proposed relaxation of the rule: "[b]ecause of the changes in the confirmation rules, the provisions of the pending bills which 'relax' the absolute priority rule standards, i.e., § 7-303(3) and (4) (delayed participation and key man contribution) are no longer necessary." *Id.* at 1941. This letter of compromise, together with the Commission's work, thus formed the basis for the Code's sections involving the absolute priority rule. *Subcommitee [sic] on Civil and Constitutional Rights of the Committee on the Judiciary, Table of Derivation of H.R. 8200*, 95th Cong., 1st Sess. 23 (Comm. Print 1977).

This compromise did not address new value issues; they had simply not been part of the debate. The natural conclusion from this silence is that the compromise fairly stated all contemplated changes. Other components of the "fair and equitable" rule -- such as the prohibition on being paid more than the allowed amount of a claim and new value principles -- remained unaffected. In short, rejection of the Commission's "relaxation" proposal did not affect other components such as new value. This conclusion is borne out by the legislative changes and statements following the compromise, none of which even suggest that changes to new value principles were intended or effected.

The first bill introduced after the compromise, H.R. 6,[10] contained nothing which affected new value. It simply contained a short statement that a court would confirm a non-consensual plan "if such plan is fair and equitable with respect to all classes except any class that has accepted the plan . . . ." *Id.*

This bill was amended two and one-half months later, again without explicit mention of new value principles. This amendment scrapped the simple injunction that the plan be "fair and equitable." In its stead it substituted a lengthy attempt to define the boundaries of fair and equitable treatment. *See* H.R. 6, 95th Cong., 1st Sess., § 1129(b), at 192-93 (Mar. 21, 1977). Successive bills added to and refined

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[10] As initially introduced on January 4, 1977, Section 1129(b) of H.R. 6 read as follows:

> (b) If all of the requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of such plan, shall confirm such plan notwithstanding such paragraph if such plan is fair and equitable with respect to all classes except any class that has accepted the plan and that is comprised of claims or interests on account of which the holders of such claims or interests will receive or retain under the plan not more than would be so received or retained under a plan that is fair and equitable with respect to all classes.

H.R. 6, 95th Cong., 1st Sess § 1129(b), at 175 (Jan. 4, 1977).

the statement of the rule. *See* H.R. 7330, 95th Cong., 1st Sess. § 1129(b), at 201-02 (May 23, 1977); H.R. 8200, 95th Cong., 1st Sess. §1129(b), at 203-05 (July 11, 1977); and H.R. 8200, 95th Cong., 1st Sess. §1129(b), at 205-07 (Sept. 8, 1977). Ultimately, the House Report reflected these changes, but categorized them as a "partial codification" of the absolute priority rule. H. REP. NO. 595, 95th Cong., 1st Sess. 414 (1977). *See* Kenneth N. Klee, *Cram Down II*, 64 AM. BANKR. L.J. 229, 240-44 (1990) (Professor Klee was a member of the House staff which worked on H.R. 8200)

After some haggling with the Senate,[11] a revised House Bill -- still numbered H.R. 8200 -- prevailed. Rather than prepare a formal conference report, the floor managers of the House and Senate chose to have virtually identical "legislative history" read into the congressional record to record the changes made in conference.[12]

The revised bill changed non-consensual confirmation considerably. H.R. 8200, as reported in House Report No. 595, had one subsection on cramdown, and did *not* use the words "fair and equitable." H.R. 8200, 95th Cong., 1st Sess. § 1129(b), at 205-07 (Sept. 8, 1977). The bill after conference split the subsection on cramdown into two paragraphs, and

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[11] The Senate attempted to substitute a bill sponsored by the Securities and Exchange Commission in place of the House version. S. 2266, 95th Cong., 2d Sess (1978). This bill attempted to preserve a two-track reorganization system, and a mandatory trustee for public companies which filed for bankruptcy protection. *Id.* § 1130. Further, non-public companies were not subject to the fair and equitable rule; public companies were. *Id.*

[12] As noted at the time, Congress believed that this procedure imbued such remarks with "the effect of being a conference report." 124 CONG. REC. 32,376 (1978)(statement of Rep. Rousselot). As this Court has subsequently noted: "Because of the absence of a conference and the key roles played by Representative Edwards and his counterpart floor manager Senator DeConcini, we have treated their floor statements on the Bankruptcy Reform Act of 1978 as persuasive evidence of congressional intent." *Begier v. IRS*, 496 U.S. 53, 64 n.5 (1990).

explicitly reintroduced the phrase "fair and equitable." H.R. 8200, 95th Cong., 2d Sess. § 1129(b), *reprinted in* 124 CONG. REC. 32,350 (1978).

The first paragraph of the revised bill -- now found in Section 1129(b)(1) -- harkened back to H.R. 6 by providing that a court could cram down a plan over a dissenting class only if the plan was, among other things, "fair and equitable." Although the bill did not attempt to explicitly define this concept, Congress' efforts to define it during the early part of 1977 were not lost. These efforts were added as a second paragraph -- now found in Section 1129(b)(2) -- which contained the various non-exclusive examples developed in earlier bills.

In short, the new bill fused Congress' prior efforts, keeping the early effort started in H.R. 6 as the general rule, and using the later effort, found in the early versions of H.R. 8200, as specific examples of the general rule. As the floor remarks made clear, courts were not to exclude other components and interpretations.[13]

This history shows that in 1978 Congress sought, through retention of the phrase "fair and equitable," to retainn both the wording and the learning of past reorganization practice. As before with the 1938 amendments, the exact contours of a "fair and equitable" plan were left in the care and development of the judiciary. Also as before, as shown by the lack of any direct attack on *Case*, new value principles continued undiminished as part of the history and the content of the phrase "fair and equitable."

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[13] *Id.* at 32,407 (statement of Rep. Edwards); *id.* at 34,006 (statement of Sen. DeConcini) ("Although many of the factors interpreting 'fair and equitable' are specified in paragraph (2), others, which were explicated in the description of section 1129(b) in the House report, were omitted from the House amendment to avoid statutory complexity and because they would undoubtedly be found by a court to be fundamental to 'fair and equitable' treatment of a dissenting class.").

B. *Congress' Use of "Fair and Equitable" Incorporated Into Section 1129(b)(1) a Dynamic Rule That Covers Far More Than Section 1129(b)(2)'s Examples*

That Section 1129(b)(1) is not limited by Section 1129(b)(2)'s examples is shown by the introductory material of Section 1129(b)(2). It introduces the various examples with the word "includes," which under the Code is expressly non-inclusive. 11 U.S.C. § 102(3) ("'includes' and 'including' are not limiting").

It can also be seen from the floor statements indicating that what was accomplished was only a partial codification, *see* note 13 *supra*, from what remains uncodified, and from recent developments in application of the concept.

1. The Uncodified Components

The scope of the unmentioned and non-excluded items was broad and basic. It is demonstrative of the scope of reliance on past practice that *neither* Section 1129(b)(1) *or* Section 1129(b)(2) even *uses* the words "absolute priority." The drafters just assumed that courts would continue to apply that principle even if it were not named.

Other essential concepts failed to receive explicit statutory expansion. Chief among these was the basic rule that no participant should receive more than its nonbankruptcy entitlement. *New England Coal & Coke Co. v. Rutland R. Co.*, 143 F.2d 179, 186 (2d Cir. 1944); In re *Evans Prod. Co.*, 65 B.R. 870, 873 (S.D. Fla. 1986); COLLIER ON BANKRUPTCY, *supra*, ¶ 1129.04[4][a][ii]. *See also* 124 CONG. REC. 32,407 (1978) (statement of Rep. Edwards); *id.* at 34,006 (statement of Sen. DeConcini) ("For example, a dissenting class should be assured that no senior class receives more than 100% of the amount of its claims. While that requirement was explicitly included in the House bill, deletion is intended to be one of style and not one of substance."). Also omitted were components related to post-

petition interest and "step-up" when senior creditors are paid in junior securities. *See* Klee, *supra*, at 234-37 (unclear if senior creditors must receive post-petition interest before junior creditors receive anything); 237-38 (unclear if senior creditor may be paid in securities inferior in priority or quality to those issued to junior creditors). *See also* COLLIER ON BANKRUPTCY, *supra*, at ¶ 1129.04[4][b][i].

2. Cases of Literal Compliance with Section 1129(b)(2) That Nonetheless Are Not "Fair and Equitable"

Section 1129(b)(2) not only omitted essential components of the concept of "fair and equitable," it left room for judicial expansion of that concept. As an example, some courts have explored a new area of the fair and equitable rule: a prohibition against the unfair and unreasonable shifting of risk relating to the operations and financial performance of the reorganized debtor. *FSLIC v. D&F Constr., Inc.* (In re *D&F Constr., Inc.*), 865 F.2d 673, 675 (5th Cir. 1989); *Aetna Realty Inv., Inc. v. Monarch Beach Venture, Ltd.* (In re *Monarch Beach Venture, Ltd.*), 166 B.R. 428, 436 (C.D. Cal. 1993); COLLIER ON BANKRUPTCY, *supra*, at ¶ 1129.04[4][b][ii].

These cases demonstrate the fluid and dynamic nature of the "fair and equitable" rule. This open-textured approach is in line with congressional intent and the structure of the Code. Against such a background, it is inconceivable that Section 1129(b)(2)(B)(ii) was intended, without ever saying so, to erase over a century's worth of reorganization practice explicitly recognizing the ability of owners in an insolvent company to contribute new capital and receive in return an ownership interest in the reorganized entity.

III. New Value Concepts Are Part of the Logic and Policy of the "Fair and Equitable" Rule

Throughout the development of the "fair and equitable" principle, owners have always been a source of the fresh

funds often necessary to effect feasible reorganizations. And, as shown below, there is a logical basis and a policy basis for permitting them to make such contributions.

A. *New Value is Logically Identical to Absolute Priority*

Many have labeled the "new value" line of cases as an exception to *Case*'s absolute priority. This is incorrect. Properly applied, new value cases and the absolute priority rule yield the same result.[14] The absolute priority rule simply requires that all of a debtor's value [15] be allocated to senior interests before junior interests can participate on the basis of their pre-petition claims. As stated in *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R.R.*, 318 U.S. 523 (1943), absolute priority rule is met if "each security holder in the order of his priority receives *from that which is available* for the satisfaction of his claim the equitable equivalent of the rights surrendered." *Id.* at 565 (emphasis supplied). *Cf. Kansas City Terminal Ry. Co. v. Central Union Trust Co. of New York*, 271 U.S. 445, 454 (1926) ("Unsecured creditors of insolvent corporations are entitled to the benefit *of the values which remain after lienholders are satisfied*, whether this is present or prospective, for dividends or only for purposes of control.") (emphasis added).[16]

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[14] These relationships can be represented algebraically, and shown to be equivalent. *Owners, Auctions, supra*, at 125-128.

[15] The value available to creditors is often referred to as reorganization value, or the value of the company as a going concern. The bankruptcy court typically determines this value, by application of various means of valuation, such as capitalized earnings, *Group of Institutional Investors*, 318 U.S. at 525-26, or other more modern methods such as discounted present value or stock beta analysis, COLLIER ON BANKRUPTCY, *supra*, ¶ 1129.06.

[16] Against this background, this Court, in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), overstated the scope of the absolute priority rule. This Court said that "the absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for *in full* before any junior class can receive or retain any property [under a

As a consequence, absolute priority requires that an amount equal to reorganization value be "first appropriated" to payment of dissenting classes of creditors before junior classes may share on account of their pre-petition interests. In short, debt has first call on the value of all corporate assets before equity.

Case's statement of new value, however, imposes the same condition. Under *Case's* new value principles, "where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder." *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 122 (1939). Under this test, the money or money's worth contributed must be "reasonably equivalent" to the stockholder's "participation" in the reorganized debtor. In short, the old owners will trade money for an equity interest in the reorganized debtor. If all reorganization value is not first allocated to senior interests, however, then any equity interests -- since they are the residual interests -- will capture some of that value, a result expressly denied by *Case*. As a consequence, any new value plan which complies with *Case* must first allocate all reorganization value, through long-term notes or other property, to senior dissenting claimants before the infusion of new capital.

This, however, is the same condition required by absolute priority. As a consequence, the combination of the two *Case* requirements -- fresh value and reasonable equivalence -- are no more than an alternative statement of the absolute priority rule, and any plan -- such as the one in this case -- which complies with new value principles also will satisfy absolute priority.

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reorganization] plan." *Id.* (emphasis supplied). Not only is this statement contrary to this Court's prior jurisprudence, it also, as shown below in Section III.B., has far-reaching and pernicious implications for bankruptcy policy generally.

B. *New Value Concepts Are Essential to Reorganization Policy*

The ability of owners to contribute new value also promotes reorganization policy. As stated by this Court, "[t]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." *NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 528 (1984). *See also United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983)("By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners. . . . Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.'"); H.R. REP. NO. 595, 95th Cong., 1st Sess. 220 (1977).

As noted in *Kansas City Terminal*, "additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them." As a consequence, barring or handicapping owners from participating in reorganizations makes no sense. Such a result is unwise, especially in light of studies that show that an increased number of bidders for an object tends to increase the object's final price. *See, e.g.*, Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. ECON. LIT. 699, 710-11 (1987); Lance Brannman, J. Douglas Klein & Leonard W. Weiss, *Concentration and Winning Bids in Auctions*, THE ANTITRUST BULLETIN 27, 30-31 (Spring 1984); Charles A. Holt, Jr., *Uncertainty and the Bidding for Incentive Contracts*, 69 AM. ECON. REV. 697 (1979).

If owners may bid for a debtor by proposing a plan, there will then be an increased pool of bidders, potentially leading to increased competition, and increased bids, for the reorganized debtor. Anecdotal evidence in bankruptcy tends to confirm this theory. More bidders mean higher dividends. *See Owners, Auctions*, at 110 n.244 (detailing how competitive bidding in

the cases of Lionel Trains and Financial News Network increased final bids, respectively, from $43 million to $76.8 million, and from $90 million to $146 million).

Unless creditors' participation rights end when they receive their aliquot share of reorganization value, the Bankruptcy Code will also have eroded seriously state laws limiting the liability of investors such as shareholders and limited partners; in short, it will impliedly make investors the guarantors of all pre-petition debt as a condition of continued participation. Not only was such a rule never contemplated by Congress, it would also have the practical effect of eliminating existing investors as contributors of the capital most businesses need to reorganize. The reasons for this elimination are simple. Requiring payment of the full amount of all claims for investors would establish a two-tier pricing system of debtors in bankruptcy: one for existing investors (the full amount of all outstanding claims); and another for new investors (reorganization value). This two-tier pricing would inevitably discriminate against pre-petition owners and investors by making their continued participation more expensive based solely on their status as investors or equity holders. One untoward consequence of such a rule would be the artificial depression of the market in new capital for reorganizing companies. *See Owners, Auctions, supra*, at 106-107.

The last thing that this Court should do is fashion a rule that eliminates or reduces competition for bankruptcy debtors -- and thus reduce creditor dividends -- by excluding or handicapping a group that historically has been ready and willing to invest new funds.

CONCLUSION

New value principles are an historic and logical part of business reorganization practice. Nothing in the language or the structure of the Code changes these practices. The judgment of the Court of Appeals should be affirmed.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION,
SUCCESSOR BY MERGER TO BANK OF AMERICA ILLINOIS,
Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF CREDIT MANAGEMENT IN SUPPORT OF RESPONDENT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	2
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. CONGRESS CAREFULLY BALANCED THE INTERESTS OF COMPETING CREDITORS, WITH A STATED AIM FAVORING REORGANIZATION OF TROUBLED BUSINESSES	4
II. THE CONGRESSIONAL SCHEME IS PREDICATED ON AMPLE ACCESS TO CAPITAL TO PROMOTE SUCCESSFUL REORGANIZATIONS	12
III. THE CONGRESSIONAL SCHEME DOES NOT REQUIRE THAT REORGANIZATION PLANS BE AUCTIONS	16
CONCLUSION	25

TABLE OF AUTHORITIES

CASES — Page

Figter Limited v. Teachers Ins. and Annuity Ass'n of America (In re Figter Limited), 118 F.3d 635 (9th Cir.), *cert. denied*, 118 S. Ct. 561 (1997) 23
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NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984) .. 9
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Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 13, 18
United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc. Ltd., 484 U.S. 365 (1988) 22
United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) 9
In re Woodbrook Assoc., 19 F.3d 312 (7th Cir. 1994) 11

STATUTES

11 U.S.C. § 362(d) 7
11 U.S.C. § 506 6
11 U.S.C. § 1121(b) 4, 17, 19
11 U.S.C. § 1121(d) 17, 20
11 U.S.C. § 1123 .... 4, 10
11 U.S.C. § 1126(c) 9, 24
11 U.S.C. § 1128(b) 4
11 U.S.C. § 1129 4
11 U.S.C. § 1129(a)(10) 6
11 U.S.C. § 1129(b) 9
11 U.S.C. § 1129(b)(1) 3-4, 6, 10
11 U.S.C. § 1129(b)(2)(A) 7
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TABLE OF AUTHORITIES—Continued

Page

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	Page
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Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 Yale L. J. 437 (1992)	14
James J. White & Robert S. Summers, *Uniform Commercial Code* § 25-9 (3d ed. 1988)	6

IN THE
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203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF CREDIT MANAGEMENT IN SUPPORT OF RESPONDENT

The National Association of Credit Management ("NACM") respectfully submits this brief *amicus curiae* in support of Respondent.[1] Petitioner (the "Bank") and respondent ("Reorganized LaSalle") have consented to the filing of this brief, and their letters of consent have been filed with the Clerk of the Court.

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[1] In accordance with Supreme Court Rule 37.6, NACM represents that no party other than counsel for NACM authored this brief, in whole or in part, and no person or entity, other than NACM, has made a monetary contribution to the preparation or submission of this brief.

INTEREST OF *AMICUS CURIAE*

NACM is a non-profit professional trade association comprising approximately 30,000 members who are unsecured credit grantors involved in all aspects of the granting and extension of commercial credit. For more than 100 years, NACM has been the single trade association representing the interests of unsecured credit grantors in commercial transactions. NACM's membership represents the entire spectrum of those who extend commercial credit, from representatives of the largest publicly held national corporations to small local manufacturers, wholesalers, distributors and retailers.

Members of NACM participate in virtually every case commenced under Chapter 11 of the Bankruptcy Code that involves a business entity. In significant Chapter 11 reorganizations under the Bankruptcy Code since its enactment in 1978, NACM members have chaired and participated in nearly all creditors' committees, which are chosen to represent the unsecured creditor body. The interests of NACM members often diverge from the interests of secured creditors, especially in cases involving the question at issue in this appeal. Unlike secured creditors that have a mortgage or other security interest in property of the debtor, NACM's members provide unsecured credit to the debtor pre-bankruptcy and then provide unsecured trade credit to continue the operation of the debtor business. Thus, NACM members are essential to a company's ongoing viability as debtor in possession and later as a reorganized entity post-confirmation.

Unlike some of the amici on behalf of the Bank, NACM's members are involved in almost every type of Chapter 11 reorganization proceeding, not just those involving real property. Because the outcome of this case will affect the entire spectrum of bankruptcy reorganization proceedings, from the smallest case to the largest case and in every business sector, the Court's review of

the instant case will profoundly affect all unsecured commercial credit grantors.

SUMMARY OF ARGUMENT

1. This Court need not venture beyond the language of the Bankruptcy Code to resolve the issue before it. When, as in this case, two classes of unsecured creditors are not paid in full and one class votes in favor of the proposed plan while the other class votes against the plan, the Code requires confirmation of the plan supported by the class voting in favor of it if additional conditions are met. 11 U.S.C. § 1129(b)(1). When one class votes against the plan, equity owners of the pre-bankruptcy debtor are barred from *receiving property under a confirmed reorganization plan* only if such property is given *on account of* their equity ownership in the pre-petition business. No section of the Code prohibits any group—past creditors, past equity owners or complete strangers—from purchasing either assets or equity ownership in the newly reorganized debtor through a Chapter 11 plan.

2. Both the principle and practice that some owners of the pre-bankruptcy business purchase stakes in the newly-reorganized business was well established under the Bankruptcy Act of 1898. The Supreme Court made clear that no one was barred from purchasing equity in a reorganizing business, if they paid fair consideration for their purchase. *Northern Pac. Ry. Co. v. Boyd*, 271 U.S. 445 (1926). If Congress had intended to overrule this long-established view, it could easily have done so by explicitly prohibiting the participation of previous investors in any subsequent plan of reorganization. Congress did not.

3. The plain language of the Code reflects a coherent view of bankruptcy policy. Chapter 11 favors debtor rehabilitation over liquidation, so long as the creditors are adequately protected. When creditor groups differ over whether a plan should be confirmed, the Code requires

confirmation with the added restrictions that the plan not "unfairly discriminate" among the classes that accepted and rejected the plan and that the plan be "fair and equitable." 11 U.S.C. § 1129(b)(1). In recognition of the frequent need for cash infusions in business reorganizations, Congress did not bar anyone from purchasing property or equitable ownership of the business. Those who make no contribution are barred from taking value unless higher priority classes either are paid in full or consent to such an arrangement. But a single class of creditors does not have the power to defeat a plan that other creditors support and that meets the numerous requirements for plan confirmation solely because the dissenting class objects to the source of the funds contributed by one or more investors in the soon-to-be-reorganized company.

If dissenting creditors wish to object to the tems of a purchase and sale under a reorganization plan, the Code provides a number of mechanisms for doing so. 11 U.S.C. §§ 1123, 1129 (specifying more than 30 elements of a plan eligible for confirmation). If a creditor wishes to object to a debtor's exclusive right to propose a plan and to propose its own plan, it may do so. Additionally, it may object to the confirmation of any plan proposed by any party. 11 U.S.C. §§ 1121(b), 1128(b). But automatic disqualification of any plan based on who invests in the reorganized company presents a novel argument that is contrary to long-established bankruptcy policy.

ARGUMENT

I. CONGRESS CAREFULLY BALANCED THE INTERESTS OF COMPETING CREDITORS, WITH A STATED AIM FAVORING REORGANIZATION OF TROUBLED BUSINESSES.

Plan confirmation is not a two-party negotiation between a debtor and a creditor. Characterizing the issue as a competition between the rights of the debtor and the

rights of the creditor misapprehends the central function of business reorganization: Chapter 11 is a court-imposed settlement of multiple relationships affecting a number of parties. Some parties are direct stakeholders in the case, including secured creditors, unsecured creditors, and equity holders. Managers of the debtor and trustees are identified parties in interest. In addition, employees who may lose jobs, communities that may lose important businesses, taxing authorities that may lose sources of revenue and other businesses that may lose critical customers or suppliers were very much in the mind of Congress as it determined how many hurdles would be erected to the reorganization of a potentially viable business. *See, e.g.*, 124 Cong. Rec. 32,392 (Sept. 28, 1978) (statement of Rep. Edwards) (discussing policies in the new Code to "protect the investing public, protect jobs, and help save troubled businesses"); H.R. Rep. No. 95-595, 53-62 (Sept. 8, 1977), *reprinted in* 1978 U.S.C.C.A.N. 6014, 6023 (discussing concern about the community impact of business failure); 124 Cong. Rec. 33,990 (Oct. 5, 1978) (statement of Sen. DeConcini) (discussing "the public interest" beyond the interests of the disputing parties). The question before this Court is whether Congress decided that a single class of creditors could prevent the confirmation of a feasible plan of reorganization because any part of the funds for reorganization came from a party who had an equitable ownership interest in the prefiling business.

The Solicitor General suggests that if a plan is a good plan, then the creditors will vote for it. *Solicitor's Brief* at 27. This is undoubtedly true, and it may be the reason that Congress required that at least one class of impaired creditors vote in favor of a plan of reorganization before it can be adopted over the objection of a dissenting class. But the problem is not, as the Solicitor General's brief seems to suggest, what to do when no creditors favor a

plan the debtor proposes; those plans cannot be confirmed as a matter of law. 11 U.S.C. §§ 1129(a)(10), (b)(1). The problem occurs when one class of creditors supports the plan while another class rejects it.

The problem of choosing between classes of creditors that support the plan and classes that oppose the plan is particularly acute because some creditors vote strategically in Chapter 11 cases. Some creditors appear in only one class, while other creditors appear in two classes. This happens because of the claims calculation procedure in the Code. When a secured creditor is owed more money than the value of the collateral securing the loan, the claim is bifurcated into its secured and unsecured portions, each portion of which is treated separately under the plan. 11 U.S.C. § 506.

Secured creditors frequently favor liquidation so that they can seize control of specific assets, knowing they can rely on these assets for payment rather than on a stream of payments from the ongoing business. For some secured creditors, the seizure of assets results not just in repayment of the debt, but in substantial profits: UCC 9-504 permits a creditor to seize collateral subject to a security interest and, after proper notification to the debtor, re-sell the assets and keep all the proceeds, even if they exceed the value of the loan.[2] In addition, through foreclosure of the assets, secured creditors can sometimes effectively seize an entire business and maintain operations, free of the claims of unsecured creditors and the old owners. In recognition of this fact, Congress decided that secured creditors may not exercise their contractual

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2 Barkley Clark, *The Law of Secured Transactions Under the Uniform Commercial Code* ¶ 4.09[2] (rev. ed. 1993); James J. White & Robert S. Summers, *Uniform Commercial Code* § 25-9 (3d ed. 1988); 2 Grant Gilmore, *Security Interests in Personal Property* § 44.6 (1965).

rights to seize collateral when the debtor is in default, so long as the debtor can provide adequate protection of the value of the collateral. 11 U.S.C. § 362(d). In the same vein, Congress decided that secured creditors may not block a reorganization, so long as they are paid the present value of the collateral under the plan. 11 U.S.C. § 1129(b)(2)(A).

Because their bankruptcy claims are bifurcated into secured and unsecured portions, undersecured creditors get the chance to vote the unsecured portion of their claims. Such creditors may willingly give up any chance at a distribution as unsecured creditors in order to liquidate assets or take control of the business in their role as secured creditors. By contrast, some creditors, such as trade creditors, employees, and tort victims of the debtor, have no secured claims and no collateral to call on. They will be paid only if the debtor is reorganized. When two classes of unsecured creditors vote in a Chapter 11, one votes its best interests as a secured creditor while the other votes its best interests as a creditor who can recover only through reorganization.

The interests of secured and unsecured creditors diverge in yet another way. Once the debtor is in financial trouble, the secured creditor has no interest in a continuing business relationship with the debtor and frequently terminates the business relationship. The secured creditor hopes to be paid in full and exit without a loss. For many of the unsecured creditors, however, the relationship continues. Unsecured creditors, particularly tradespeople and employees, typically will continue to do business with the company while it is in bankruptcy and hope for a future with the company as a customer, supplier, or employer after the reorganization. In effect, many trade creditors continue to invest in the debtor by either selling goods on credit or buying goods on credit after the bankruptcy filing. Even employees invest in the

debtor with labor, wage give ups and loans from employee pension plans. The view of secured and unsecured creditors often diverge sharply as they consider the possibility that a troubled business may reorganize in bankruptcy.

Congress provided for bifurcation of claims in order to limit the leverage of secured creditors, which had often exceeded their interest in recovering the value of their collateral. The legislative history explicitly addressed the policy decision, opting to limit the power of the secured creditors in order to promote the reorganization of failing businesses.[3] Bifurcation of claims posed no obvious threat to the debtor's ability to reorganize because the plan proponent was given the opportunity to confirm a plan that had the backing of at least one im-

[3] Congress provided for bifurcated claims to try to limit the power exercised by secured creditors, particularly those creditors with undersecured loans. The Report of the Committee of the Whole House on the State of the Union states:

> Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors . . . . Current law is ambiguous and vague, especially under Chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an undersecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor. . . . Because of the uncertain treatment of secured creditors under current law, the debtor is often required to err on the side of overprotection when formulating a reorganization or repayment plan. Secured creditors have exercised great leverage by virtue of the uncertainty, and have made reorganization and individual repayment plans more difficult to consummate than would be the case under this bill. Since a successful reorganization or Chapter XIII plan inures to the benefit of all creditors, the change under the bill should increase recoveries by creditors generally.

H.R. Rep. No. 95-595. As this language illustrates, it was not the intent of Congress to create a veto power for undersecured creditors.

paired class of unsecured creditors—even if the plan was opposed by another class of creditors. 11 U.S.C. § 1129(b). This mechanism sharply curtails the power of a dissenting class of unsecured (or undersecured) creditors to derail an otherwise-confirmable plan.

The overall scheme of the Code is consistent: Dissenting creditors within a class are overridden if the class votes to accept the plan, making it possible to confirm a plan "by consent" even when some creditors object. 11 U.S.C. § 1126(c). Similarly, dissenting classes are overridden if another class accepts the plan and the other requirements of section 1129 are met. 11 U.S.C. § 1129(b).

In favoring reorganization, the Code expresses the deliberate policy choices made by Congress. "It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets." H.R. Rep. No. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 6014, 6179. This Court has also consistently recognized that principle: "The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984). "By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners. . . . Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap' " *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983).

The Code balances the interests of accepting and dissenting creditors by imposing specific requirements before a plan may be adopted over the objection of a dissenting creditor: the plan may not unfairly discriminate among classes, the plan must be fair and equitable, and the plan may not distribute any value to pre-petition equity holders

on account of their ownership claims over the objections of a dissenting creditor class. 11 U.S.C. §§ 1129(b)(1), (2)(B)(ii). If the plan proponent can satisfy these three requirements, in addition to all other requirements in 1123 and 1129(a), then the plan must be confirmed. Congress understood the divergence among different stakeholders, emphasizing that protection for those other stakeholders "should not be left to a plan negotiated by a debtor in distress and senior or institutional creditors who will have their own best interest to look after." S. Rep. 95-989, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5796. The Code tilts toward confirmation of a plan that is both supported by one or more creditor groups and is otherwise equitable in its treatment of the dissenting creditors; the Code denies a single undersecured creditor the power to deplete the remaining value of a failing business.

The Code neither restricts the source of funds for the reorganization of the debtor nor gives any party the right to stop a reorganization because it objects to the source of the funds to be used in the reorganization. To do so would enhance the power of dissenting classes, giving secured creditors with bifurcated claims a much greater opportunity to force liquidation of viable companies or to seize control of such companies, thereby wiping out the interests of the unsecured creditors and equity. Such a rule would re-create the "hold-out" problem that the 1978 Code was designed to correct.[4] Under the Act, a

[4] Efforts to deal with the holdout problem in reorganizing a failing business long pre-date the adoption of the 1978 Bankruptcy Code. Professor Markell explains:

> Starting in 1874, federal legislation attempted to foster compositions by providing that, if certain procedural requirements were met, a less than unanimous composition could be confirmed by a bankruptcy court. Its terms would then become binding on all creditors, even those who did not agree with the composition. The 1874 legislation, which had its roots in English and Scottish law, bound dissenting creditors if two requirements were met: first, approval by a majority of creditors, holding three-quarters of the debt owed, who were present at a duly convened meeting of creditors, and second, written confirmation of the earlier approval by at least two-thirds of all the debtor's creditors who themselves held at least a majority of the debt owed by the debtor.

Bruce Markell, *Claims and Opinions: Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 Bankr. Dev. J. 1 (1994/95) (footnotes omitted).

Finance specialists note that Chapter 11 reorganizations enjoy an advantage over workouts outside bankruptcy because they can solve the holdout problem. *See, e.g.*, Varouj A. Aivazian & Jeffrey L. Callen, *Corporate Leverage and Growth*, 8 J. Fin. Econ. 379, 397 (1980).

creditor who refused to go along with a plan supported by other creditors could hold out, threatening to vote no unless the other creditors or new equity investors paid something more to the holdout. To curb the holdout problem, the 1978 Code provided both that creditors vote by class and that no single class block a plan, thereby sharply curtailing the veto power of a single creditor or small group of creditors. Because their power to block a plan has been reduced, the holdout creditor's negotiating leverage during the course of a Chapter 11 case is also checked.[5]

The briefs make clear that the secured creditors want more power in a business reorganization than the Code currently gives them. The unsecured creditors, for whom

[5] In the instant case, the secured creditor negotiated for a nonrecourse loan, voluntarily restricting its recovery to the collateral itself. It has a voting position in this case only by operation of section 1111(b), which was added to the Code in 1978 to protect nonrecourse secured creditors from having "consensual" plans imposed on them. Section 1111(b) allows undersecured creditors to vote the unsecured portions of their claims. The Seventh Circuit requires those claims to be separately classified. *In re Woodbrook Assoc.*, 19 F.3d 312, 319 (7th Cir. 1994). The secured creditors in this case propose to take that opportunity to vote and turn it into a sword to block any plan they do not support. There is no suggestion in any part of the legislative history that Congress intended them to enjoy such power by virtue of their new-found voting rights.

the reorganization effort is largely directed, oppose this effort to shift the balance carefully constructed by Congress.

II. THE CONGRESSIONAL SCHEME IS PREDICATED ON AMPLE ACCESS TO CAPITAL TO PROMOTE SUCCESSFUL REORGANIZATIONS.

Most businesses undergoing financial reorganization need access to new capital. Some will use the money to modernize their facilities. Others will use the new capital to make their payroll and pay the costs of operation until the business generates sufficient revenue to pay its own bills. It is a rare business in Chapter 11 that does not need a new source of funds as part of its reorganization plan.

For very large companies, access to the capital markets may be largely unrestricted. Because of the bankruptcy, the costs of funds may be high, but they are likely to be available. For smaller businesses, however, capital is more difficult to find,[6] a problem that is magnified for the small business in bankruptcy.[7] The market for debt for dis-

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[6] Robert F. Reilly, *Value and Cents: Valuation—Big Businesses vs. Small Businesses*, 1995 Am. Bankr. Ins. J. 126 (September 1995), observes: "Generally, big businesses have debt financing available, regardless of the credit worthiness of the owners, whereas it is not generally available for the smaller business. Alternative sources of financing, such as the owner's capital, are needed. In addition, personal guarantees are typically required for debt financing for small businesses." *See also* Alan Schwartz, *A Theory of Loan Priorities*, J. Legal Stud. 209 (1986); Robert Scott, *A Relational Theory of Secured Financing*, 86 Colum. L. Rev. 901 (1986); Marsh, *The Choice Between Equity and Debt: An Empirical Study*, 37 J. Fin. 121 (1982).

[7] As one analyst observed, the argument that modern capital markets provide adequate access to funds needed for reorganization might apply to large entities filing Chapter 11, but "it ignores the difficulty that small businesses may encounter when trying to raise substantial new capital. Small business owners may not have the

tressed small businesses is so limited that old owners of the business may be the only source for new capital.[8]

There are a number of reasons that old equity may be more inclined to finance a small business than a stranger would be.[9] Information costs for small companies are high, and old equity may know more about the distressed company than new investors. In some cases, old equity actually runs the business. Preservation of the business may mean preservation of jobs for the owner or family members. In other cases, such as the instant case, old equity will derive some tax advantages if the business is not liquidated. In still other cases, equity will have made personal guarantees to one or two creditors, and they hope that by making an additional investment in the business that it will survive to pay the guaranteed loans. Sometimes old equity will make a new investment in the business because they can make unique contributions, such as business contacts, that would be lost if the business were owned by strangers. Whatever the specific reason, most owners of small businesses continue in their ownership position after a Chapter 11 reorganization, often with the consent of their creditors. Lynn LoPucki, *The Debtor in Full Control—Systems Failure under Chapter 11 of the Bankruptcy Code?*, 57 Am. Bankr. L.J. 247, 267-68 (1983).

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collateral and resources available to larger corporations making it more difficult for them to borrow money in today's capital markets." (footnotes omitted). Michelle Craig, *Note & Comment: The New Value Exception: A Plea For Modification or Elimination*, 11 Bankr. Dev. J. 781 (1995), in a discussion of the briefs filed in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988). *See also* Charles W. Adams, *New Capital For Bankrupt Reorganizations: It's The Amount That Counts*, 89 Nw. U.L. Rev. 411, 426 (1995) (stating that "an insolvent corporation's former owners are often the only feasible source of new capital").

[8] Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L., 1991 N.Y.U. School of Law 9, 15-16, 19-22.

[9] *Id.* at 19-22.

Small businesses with restricted access to capital make up the bulk of the companies that use Chapter 11. In the eleven year period from 1980 to 1991, for example, publicly traded companies represented less than one-tenth of 1% of all Chapter 11 cases (0.000936 of the cases).[10] For many of the 99.9% private companies in bankruptcy, access to capital infusions from former owners of the business may be the only hope for survival of the business.

When Congress drafted Chapter 11, it planned to cover all types of business with a single scheme, replacing the three-part business reorganization system of the 1898 Act. Under the Act, after 1952, neither Chapter XI (for small businesses) nor Chapter XII (for real estate entities) had an absolute priority rule. Absolute priority was recognized only in Chapter X, for publicly traded companies, and then only with its new value corrollary. It would have been a quite remarkable step for Congress to deny access to capital in the largest bulk of cases to be covered by the new Chapter 11 with no debate, no legislative history and no direct language to make clear that a sea-change in reorganization law was taking place.[11]

The practical advantages of permitting old equity the opportunity to participate in a reorganized business in return for a cash contribution has infused the development of reorganization law. Early courts recognized that everyone may benefit when the creditors make deals with the equity owners to get a business back on its feet. Neither the bankruptcy law nor common law required that equity be barred from any participation in the post-bankruptcy business. In 1926, this Court stated:

> Generally additional funds will be essential to the success of the undertaking, and it may be impossible

[10] Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 Yale L.J. 437, 441 (1992).

[11] *See* Bruce Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy*, 44 Stan. L. Rev. 69, 101-02 (1991).

> to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases, the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.[12]

If Congress had not wanted old equity to continue to participate in plans of reorganization, it could have easily said so. It could have barred equity participation, either directly or by permitting a single class of creditors to block any plan to which it objected—thus permitting equity participation and confirmation of a plan only with the consent of every class. The amicus brief of the law professors specifically proposes that this be made the law:

> The code puts the reorganization decision in the hands of the creditors who are the residual owners of the insolvent firm. Here those creditors have decided to reject the plan proposed by the prepetition equity holders. . . . If the equity holders cannot convince the creditors that such a concession is in the creditors' own interest, it makes little sense to allow a bankruptcy court to substitute its opinion for that of the creditors.

Law Professors' Brief at 4. Both the Bank and the Solicitor General endorse this approach, asserting that "creditor consent" is a prerequisite for confirmation. *Petitioner's Brief* at 30; *Solicitors' Brief* at 27. This approach reads section 1129(b) out of the Code, substituting instead a scheme that permits a single creditor class to veto a plan. But Congress specifically permitted plans to be confirmed with the support of one class of creditors and the objection of another.

The Code does not bar participation of old equity in business reorganizations. Despite the fact that small businesses have gone back to their equity owners for additional infusions of cash throughout this century, Congress

[12] *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445 (1926).

elected to restrict the participation of equity in plans only by saying that equity could not "receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii). The Code unambiguously permits old equity to participate if it receives something other than "property" *or* if it receives property in some way other than "under the plan" or if it receives value "on account of" something other than its pre-bankruptcy claim.

III. THE CONGRESSIONAL SCHEME DOES NOT REQUIRE THAT REORGANIZATION PLANS BE AUCTIONS.

New value plans propose an exchange: equity ownership in the post-reorganization entity in return for a contribution of fresh capital. Because the new value is given in exchange for the new equity ownership, there is no violation of the absolute priority rule articulated in section 1129(b)(2)(B)(ii) which requires that old equity "not receive or retain under the plan on account of such junior interest any property." The Bank does not deny that a cash contribution in return for an equitable ownership does not violate section 1129(b)(2)(B)(ii). Instead, the Bank and amici ask this Court to impose an auction of the equitable interest any time a cramdown plan involves an equity contribution.

The fact that the plan proposed a specific sale price to a specified party that had had a previous ownership interest in the debtor is the Bank's basis for claiming a violation of 1129(b)(2)(B)(ii). The Bank explains repeatedly and with emphasis: "[T]he plan of reorganization gave the debtor's pre-bankruptcy equity holders the *exclusive* right to retain their ownership interests in the debtor if they contributed new capital." [emphasis in original] *Petitioner's Brief* at 6. This *exclusive* right under the plan is the same as in any purchase agreement: a statement of the sale price for equitable ownership, identification of the buyer and specification of the finance

terms. The Bank claims that *any* plan that proposes to sell equity in the reorganized business directly to a former equity owner is automatically ineligible for confirmation if one class of credtiors objects.

The Bank makes an interesting concession early in its brief: "We concede that the argument that pre-petition equity holders enjoy their post-petition interest 'on account of' their prior interests loses much of its force when an open auction is held . . . ." *Petitioner's Brief* at 11, n.6. The Bank is quick to point out that it is not complaining about the fact that the plan was proposed during a time when the debtor had an exclusive right to propose a plan. *Petitioner's Brief* at 6, n.4. Recognizing that sections 1121(b) and (d) grant an exclusive period to the debtor to propose a plan and that plans can—and should—be confirmed during this period, the Bank acknowledges that cramdown plans do not involve a transfer "under the plan" of any "property" interest simply because they are proposed during the period of exclusivity.

> [The Bank's argument] is not to be confused, and the Seventh Circuit did not confuse it, with the defeasible exclusivity of the debtor's right to *propose a plan*. *See* 11 U.S.C. § 1121(b). All that anyone other than old equity holders can gain if the latter exclusivity is terminated is the right to *ask the judge* to confirm a plan other than that proposed by the debtor, which may allow someone other than old equity holders to bid on the new equity. The judge is still permitted to confirm only one plan, and that plan must still satisfy the requirements of the statute. 11 U.S.C. § 1129(c) [emphasis in original]

Petitioner's Brief at 6, n.4.

Since the Code clearly contemplates the exchange of property for money and the proposal of cramdown plans during the period of exclusivity, in order to prevail, the Bank asks this Court to impose a new rule in cramdown cases: a requirement that each cramdown plan itself must provide for an auction of the equity interest. The Bank

cites no statutory language imposing such a requirement. Nor does the Bank cite any legislative history that suggests Congress had in mind auctions in all cases involving old equity. Nor does the Bank cite to a single pre-Code case in which an auction was required to permit equity participation in a plan of reorganization.

There is no evidence that, under the Act, courts required the use of auctions to transfer equity interests in new value cases. In the only new value case to reach this Court after the adoption of the Code, the old owners proposed to exchange their future labor for equity ownership of the post-reorganization business, which this Court ruled was not a cash equivalent. *Northwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988). No one—including this Court—suggested in that case that the failure to propose an auction was fatal to the adoption of the plan or mentioned auctions in any connection.

The Bank reveals the novelty of its position by admitting in a footnote that, while it is sure that the Code requires that auctions be held if new value plans are to be adopted, it is not entirely certain that the bankruptcy court can hold such auctions or that the statute provides any foundation for the terms on which they might be conducted:

> The separate question whether the bankruptcy court has the authority to hold such an auction, however—particularly on its own motion and not in the context of a plan that sets forth in detail the procedures that will purportedly govern any such "auction"—raises issues involving construction of a number of different provisions of the Code. Because no auction was held or proposed in this case, however, the question is not before the Court.

Petitioner's Brief at 11, n.6. The Bank neither specifies any of the "number of different provisions of the Code" that would be invoked to confirm every new value plan nor identifies any statutory sections that contemplate that auctions are a necessary ingredient in new value plans.

The Bank's logic is tangled. Because the Bank cuts its argument loose from the exclusive right to propose a plan, the Bank's proposal would apply even if a dozen parties proposed plans of reorganization, each of which identified a different purchaser of the post-reorganization business. By the rule proposed by the Bank, all the plans could be confirmed, even over the objection of one class of creditors, except the one that proposed an equity buyer—even if the equity buyer were the highest bidder. The Bank takes pains to avoid hinging its argument on the losing proposition that exclusivity granted under section 1121(b) becomes "property" transferred "under the plan" "on account of" the equity interest. In doing so, it creates the conundrum that a highest-value plan chosen from among competing plans would not be eligible for confirmation because it conveyed "property" to equity by proposing a specific sale price to an old equity owner rather than proposing an auction to any bidder.

As the Bank's and amici's briefs reveal, there is no colorable violation of absolute priority without an exclusivity claim. But the rules governing the exclusive right to propose a plan lie elsewhere in the Code. 11 U.S.C. § 1121(b). In fact, the Bank filed a motion in the bankruptcy court seeking to terminate the Debtor's exclusive right to file a plan and sought leave to file its own liquidation plan, which the bankruptcy court denied. The Bank neither appealed that denial nor raised that denial as an issue on appeal when the Debtor's Plan was confirmed. Presumably the motion to terminate exclusivity was properly denied by the bankruptcy court under the terms of the statute. Congress has addressed the question of debtor exclusivity in section 1121(b). The Bank asks this Court to make an end-run around that provision to make the grant of exclusivity useless in any case in which the debtor offers to finance any portion of the post-reorganization business.

Secured creditors in Chapter 11 cases are not unhappy with equity's purchase of an interest in the reorganized

entity; they are unhappy that any plan can be confirmed over their objections. They ignore the value exchanged by equity for ownership in the reorganized business, focusing their argument instead on exclusivity granted to the debtor under the Code. Once again, the congressional decision to permit a debtor an extended period of exclusivity is part of the deliberate scheme to balance the competing interests of creditors and to promote the likelihood of a successful reorganization. Congress recognized that if creditors could propose competing plans of reorganization, the plan confirmation process would be more chaotic and the likelihood that any plan would be confirmed would decline sharply.[13] Congress also recognized that having the exclusive right to propose a plan put leverage in the hands of the Debtor—leverage to confirm a plan on terms different from those proposed by the most powerful creditor, leverage to confirm plans that would pay unsecured creditors some return on their debt rather than forcing them to stand by with nothing while the secured creditors took all the assets of the business, and leverage to maintain the business and its accompanying jobs and other benefits for the local communities. By putting this power in the hands of the Debtor, the Debtor was given the opportunity to confirm plans of reorganization for businesses that otherwise would have been liquidated.

The exclusive right to propose a plan is not unrestricted. The court may "reduce or increase" the period of exclusivity "for cause." 11 U.S.C. § 1121(d). Any creditor is free to bring such a motion at any time. *Id.* There is a rich and detailed case law and academic literature about the circumstances under which plan exclusivity should be

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13 "Proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy." H.R. Rep. No. 95-595, *reprinted in* 1978 U.S.C.C.A.N. at 6191.

terminated.[14] Secured creditors may believe that courts have given Debtors too much leverage by extending plan exclusivity, while Debtors and unsecured creditors may think that courts are unrealistically restrictive in their willingness to grant exclusivity. Whether either party is right is not relevant to this case. The tension between the two demonstrates the bargaining dynamic deliberately created by Congress to push cases toward reorganization.

The secured creditor in this case hopes to make an end-run after losing its fight to have exclusivity terminated: it hopes to persuade a court to rule as a matter of law that it can veto any plan proposed during the period of exclusivity. If it could do so, it would increase the leverage of undersecured creditors far beyond what Congress contemplated, thereby upsetting the balance carefully achieved between all the competing parties who are dealing with a failing company.

Undersecured creditors may have a legitimate complaint; perhaps they should have greater power to liquidate or take over troubled companies. Of course, unsecured creditors would see that differently; they believe that undersecured creditors already exercise too much power in Chapter 11 cases, leaving trade debt, tort debt, employee retirement funds and other such creditors with too little recovery. In either case, however, the question of drawing the boundaries between debtors and creditors is one left to Congress.

Secured creditors have pressed their agenda, asking for limits on exclusivity, an absolute right to veto plans and increased powers to determine classification among different creditor groups. Thus far, Congress has rebuffed their

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14 *See, e.g.*, 7 *Collier on Bankruptcy*, ¶ 1121.06[1] (Lawrence P. King ed., 15th ed. 1998); Martin J. Bienenstock, *Symposium—Contemporary Issues in Bankruptcy and Corporate Law; Conflicts Between Management and the Debtor in Possession's Fiduciary Duties*, 61 U. Cin. L. Rev. 543, 560-61 (1992).

efforts. They now ask this Court to re-balance the bankruptcy laws in their favor.

In the instant case, the undersecured Bank holding a non-recourse loan asks for even more leverage than a fully secured creditor would have had in the same case. Fully secured creditors have no unsecured debt and hence no power to vote to block a plan. The provisions for confirmation of a plan over a secured creditor's dissent do not bar old equity owners from receiving or retaining property under the plan on account of their old interests. If undersecured credtiors are given the power to block plans by voting the unsecured portion of their claims, they will have more leverage in bankruptcy proceedings than their fully secured counterparts.

If undersecured creditors have greater leverage than secured creditors, the incentives for marginally secured creditors to under-value property increases. Petitioner asks this Court for a rule in which the ability to control a Chapter 11 rises with the amount of undersecurity a creditor can assert. This undercuts every established commercial law principle—both in bankruptcy and out—to treat fully secured creditors better than all other creditors and to encourage secured creditors to take adequate collateral to cover their loans.[15]

Using the leverage they enjoy through exclusivity and a number of other Code provisions and frequently calling on old equity for infusions of new cash, more than a quarter of the Chapter 11 cases filed from 1989 through

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15 Section 506(c), for example, permits an oversecured creditor to collect interest during the pendency of a bankruptcy while denying interest to the undersecured creditor. In *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc. Ltd.*, 484 U.S. 365 (1988), this Court refused to expand the leverage of undersecured creditors to liquidate a business by requiring interim interest payments. The Court stated, "Section 506(b)'s denial of post-petition interest to undersecured creditors merely codified pre-Code bankruptcy law, in which that denial was part of the conscious allocation of reorganization benefits and losses between undersecured and unsecured creditors." *Id.* at 373.

1995 have resulted in confirmed plans. Gordon Bermant and Ed Flynn, *Bankruptcy by the Numbers, Outcomes of Chapter 11 Cases: U.S. Trustee Database Sheds New Light on Old Questions*, Am. Bankr. Inst. J. 8, 32 (February 1998). Although their recoveries are often limited, unsecured creditors recognize that without reorganization, they would have had little chance of collecting anything in many of these cases. Only about 5% of Chapter 7 cases produce any assets for distribution to unsecured creditors. Michael J. Herbert and Domenic E. Pacitti, *Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-87*, 22 U. Rich. L. Rev. 303, 315-16 (1988). Often unsecured creditors support a reorganization even with a small payout because they hope to keep a valuable customer in the future. If this Court increases the leverage of dissenting creditors at the expense of creditors who support a plan of reorganization, liquidations will increase.

The long-term effects of eliminating new value plans would fall squarely on unsecured creditors. The leverage that comes from a debtors' opportunity to propose a plan and offer an infusion of new cash currently stimulates many secured creditors to buy up unsecured claims in the hopes of controlling the reorganization. This directly benefits the unsecured creditors, even at the expense of old equity.[16] If this Court rebuffs the new value principle, unsecured creditors will get nothing unless the debtor has unencumbered assets or is solvent. Similarly, the creditor in the instant case proposes to pay off the trade debt to

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16 Among the many examples of secured creditors buying the claims of unsecured creditors so that they could control the Chapter 11 process are *Figter Limited v. Teachers Insurance and Annuity Association of America (In re Figter Limited)*, 118 F.3d 635, 638-39 (9th Cir.), *cert. denied*, 118 S. Ct. 561 (1997); *255 Park Plaza Associates Limited Partnership v. Connecticut General Life Insurance Company (In re 255 Park Plaza Associates Limited Partnership)*, 100 F.3d 1214 (6th Cir. 1996). The returns to the unsecured creditors in these cases can be substantial.

make its petition more attractive, but if this Court establishes the principle that undersecured credtiors can terminate a reorganization effort and seize all the assets of the business, there will be no need to pay anything to any unsecured creditors in the future.

In the instant case, trade debt was a relatively small part of the business—$160,000 versus a $93 million dollar loan from a secured lender.[17] But if the secured lender can foreclose on all the assets of this business and leave nothing for the trade debt, their loss will be complete. For some tradespeople, including some of the 45 trade creditors involved in this case, the loss of $5,000 may be more difficult to recover from than the loss of millions for a creditor in the business of making loans and sharing loan participation. Congress constructed the Bankruptcy Code to make certain that a single dominant creditor could not control the reorganization process, requiring that voting within a class be based both on dollar amount of debt and number of separate creditors. 11 U.S.C. § 1126(c). The protection for smaller creditors will be written out of the statutory scheme if this Court permits a single large secured creditor to form a separate class to block a reorganization supported by another class of unsecured creditors.

Any ruling from this case will apply in a wide variety of factual settings, including those where the relative position of undersecured and unsecured creditors is reversed. The petitioner urges this court to follow a rule in which trade creditors with $93 million in outstanding debt would lose everything while a secured creditor with a $90,000 deficiency on a loan voted its unsecured debt in a separate class to block any reorganization in which part of the infusion of capital came from old equity. The ruling

[17] This characterization skips over the point that the general partner of the debtor and an affiliate held allowed unsecured claims totaling $7.7 million; the general partner held another claim based upon an $11.3 million second mortgage. App. 103a, 129a.

made by this Court will also affect efforts to reorganize businesses of all sizes, large and small. It will affect creditors with small claims and those with enormous interests, such as claimants in mass tort cases and environmental liability cases. It will also affect the reorganization possibility for nonprofit corporations and owner-managed businesses. When this Court addresses the balance to be struck among the many parties competing for payments from a troubled company, the implications will be felt by every stakeholder—secured creditors, unsecured creditors and equity—as well as every employee, every local taxing authority, every community, every supplier, and every customer of a business in trouble.

CONCLUSION

For the foregoing reasons, the NACM respectfully requests that the Court affirm the decision of the Seventh Circuit.

Respectfully submitted,

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